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Corporations

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CORPORATIONS

Glenn D. West*
Susan Y. Chao**

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I. INTRODUCTION

THE corporate law issues addressed by Texas courts¹ during this Survey period² can be grouped into three broad categories: (a) the liability of corporate officers, directors and shareholders for (i) the actions of the corporation with which they are affiliated, or (ii) their own actions on behalf of the corporation with which they are affiliated; (b) the law of “successor liability;” and (c) contract construction and interpretation issues of special interest to the corporate practitioner, including issues related to contract formation and the interplay between the sanctity of contract and the tort of fraudulent inducement.³

II. LIABILITY OF OFFICERS, DIRECTORS AND SHAREHOLDERS OF TEXAS CORPORATIONS

Despite frequent pronouncements by Texas courts that the corporate form is not to be easily avoided or ignored,⁴ Texas courts have manifested a reluctance to unequivocally afford corporate officers, directors and shareholders the basic protections of that corporate form: namely, freedom from liability for the obligations of the corporation with whom the corporate officers, directors and shareholders are affiliated—protection that has always been the most “fundamental” purpose for the formation

1. Like each of the three prior Corporations Surveys, for the purpose of this article, “Texas courts” includes not only the decisions of the Texas appellate courts and the Texas Supreme Court, but also decisions by the federal district or bankruptcy courts situated within Texas and by the United States Court of Appeals for the Fifth Circuit to the extent interpreting Texas law. Because the scope of this article is limited to a survey of Texas corporate law issues and because another survey article will specifically address such issues for this Survey period, federal or Texas cases discussing securities law issues are not discussed.

2. The Survey period is October 1, 2001 through November 1, 2002, although later cases are included to the extent they were available before the publication date.

3. The Texas courts also addressed a number of other corporate law issues during this Survey period, but the cases were of less significance. See, e.g., *In re Miller*, 290 F.3d 263, 269 (5th Cir. 2002) (concluding that in the absence of any express indemnity provision, corporation statutes govern, and because the officer was sued predominantly because of activity he undertook to obtain employment, which was for his own personal benefit, the corporation is not required to indemnify the officer); *Swain v. Wiley Coll.*, 74 S.W.3d 143 (Tex. App.—Texarkana 2002, no pet.) (effect of board ratification of otherwise unauthorized contract of corporation and persons entitled to challenge noncompliance with by-laws); *Landon v. S & H Mktg. Group, Inc.*, 82 S.W.3d 666 (Tex. App.—Eastland 2002, no pet.) (review of Texas law of director’s and officer’s fiduciary duties of obedience, loyalty, and due care and the Texas interested director statute—Article 2.35 of the Texas Business Corporations Act); *Baty v. ProTech Ins. Agency*, 63 S.W.3d 841, 852-53 (Tex. App.—Houston [14th Dist.] 2001, pet. denied); *Anderson Chem. Co. v. Green*, 66 S.W.3d 434, 442 (Tex. App.—Amarillo 2001, no pet.) (officers and employees of corporations have a duty separate from any written employment agreement not to compete with the corporation and not to disclose confidential and proprietary information).

4. See generally Glenn D. West & Brandy L. Treadway, *Corporations*, 55 SMU L. REV. 803, 804 (2002); Glenn D. West, *Corporations*, 54 SMU L. REV. 1221, 1222 (2001); Glenn D. West & Christopher M. Fairman, *Corporations*, 53 SMU L. REV. 773, 774 (2000).

of the corporate entity⁵ and protection that was specifically confirmed and enhanced by the Texas legislature in Article 2.21 of the Texas Business Corporations Act.⁶

It is clearly acknowledged⁷ that Article 2.21 was originally amended in 1989 in specific response to the Texas Supreme Court's infamous decision in *Castleberry v. Branscum*,⁸ wherein the court seemingly extended the basic concept of piercing the corporate veil beyond circumstances where the corporation had been used to perpetrate a fraud, to any circumstance in which "recognizing the separate corporate existence would bring about an inequitable result."⁹ Article 2.21, as amended, was specifically intended to overturn the business uncertainty created by *Castleberry* as to the limited liability afforded by the Texas corporate form, particularly in the context of corporate contractual obligations and tort claims arising therefrom.¹⁰ Through subsequent amendments to Article 2.21 in 1993 and 1997, Article 2.21 was further clarified and expanded in an attempt to "curb the creativity of the bench and [the] bar"¹¹ in ignoring the plain import of the statute that unequivocally makes shareholders, shareholder's affiliates and affiliates of the corporation unavailable as sources of repayment for contractual obligations of the corporation or torts arising from those contractual obligations.¹² Corporations Surveys in the past have noted a number of cases that were ripe for decision on the basis of Article 2.21, but in which the existence of Article 2.21 or its clear import was ignored by the Texas courts.¹³ That trend has continued during this Survey period.

There are basically four ways in Texas in which officers, directors or shareholders can subject themselves to individual liability to third parties dealing with the corporation: (1) executing agreements on behalf of the corporation without clearly identifying their capacity as agents of the corporation rather than as individuals;¹⁴ (2) taking an action that is prescribed by statute and that expressly subjects individual actors to

5. Gregory W. Wix, *Piercing the Corporate Veil: Should Michigan Consider Statutory Solutions?*, 79 U. DET. MERCY L. REV. 637 (2002); James Gerard Gaspard, II, *A Texas Guide to Piercing and Preserving the Corporate Veil*, 31 BULL. L. SEC. ST. B. TEX. 24, 25 (1994); Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89 (1985).

6. TEX. BUS. CORP. ACT ANN. art. 2.21 (Vernon 2003).

7. Brent Lee, *Veil Piercing and Actual Fraud Under Article 2.21 of the Texas Business Corporation Act*, 54 BAYLOR L. REV. 427, 430-31 (2002).

8. *Castleberry v. Branscum*, 721 S.W.2d 270 (Tex. 1986).

9. *Id.* at 272-73. See also Lee, *supra* note 7.

10. See Lee, *supra* note 7; Wix, *supra* note 5, at 648; Gaspard, *supra* note 5, at 33.

11. Alan W. Tompkins & Ted S. O'Neal, *Corporations and Limited Liability Companies*, 51 SMU L. REV. 817, 825 (1998).

12. See Lee, *supra* note 7, at 433; Gaspard, *supra* note 5, at 33-35; TEX. BUS. CORP. ACT ANN. art. 2.21 cmt. (Vernon 2003).

13. West, *supra* note 4, at 1226-30; West & Treadway, *supra* note 4, at 809-16. See also Mike Tankersley, *What If They Made a Law and No One Noticed?*, TEXAS LAWYER, Dec. 16, 1996, at 33; Gaspard, *supra* note 5, at 38-39.

14. See, e.g., *Taylor-Made Hose, Inc. v. Wilkerson*, 21 S.W.3d 484 (Tex. App.—San Antonio 2000, pet. denied).

individual liability, regardless of the fact that the action was taken on behalf of and even at the direction of the corporation;¹⁵ (3) committing an intentional tort¹⁶ or a negligent tort in circumstances where an individual duty of reasonable care is owed,¹⁷ such as driving a car on behalf the corporation, even if the tort was committed on behalf of or at the direction of the corporation;¹⁸ and (4) traditional “piercing the corporate veil analysis,” whether in the form of the alter ego theory or the single business enterprise theory, or in the form of the partnership-like theory of joint enterprise.¹⁹ Article 2.21 does not apply to the first two categories noted above, and it applies to the last two categories only insofar as the liability sought to be imposed on the individual is liability for a contractual obligation of the corporation or a tort arising out of a contractual obligation of the corporation.

Unlike prior Survey periods, the first means of imposing individual liability—executing agreements on behalf of the corporation without clearly identifying the agent capacity in which an officer, director or shareholder was so executing the agreement—did not present itself in any meaningful decisions during this Survey period. However, the Fifth Circuit did have occasion to reaffirm that a corporate officer or director, as an agent of the corporation, is an individual separate and apart from the corporation, and where that agent signs a contract as an agent of the corporation only, “he does not thereby bind himself personally to the agreement.”²⁰ Similarly, although there were a number of cases that addressed the fourth means of imposing liability—the traditional alter ego, single business enterprise and joint enterprise doctrines²¹—none of these cases were remarkable.

15. See, e.g., *Love v. State*, 972 S.W.2d 114 (Tex. App.—Austin 1998, pet. denied).

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

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

18. See, e.g., *Leitch v. Hornsby*, 935 S.W.2d 114 (Tex. 1996). See also *Kingston v. Helm*, 82 S.W.3d 755, 762 (Tex. App.—Corpus Christi 2002, pet. denied); *Gaspard*, *supra* note 5, at 35.

19. See, e.g., *Nichols v. Pabtex, Inc.*, 151 F. Supp. 2d 772 (E.D. Tex. 2001).

20. *Beiser v. Weyler*, 284 F.3d 665, 667 (5th Cir. 2002). See also *Pabich v. Kellar*, 71 S.W.3d 500 (Tex. App.—Fort Worth 2002, pet. denied). Similarly, the opposite is also true that while the actions of a corporate officer on behalf of the corporation are presumed to be the corporation's actions, “an agent who steps outside the boundaries of his authority acts independently and not on behalf of the corporation.” *Mars, Inc. v. Gonzalez*, 71 S.W.3d 434, 437 (Tex. App.—Waco 2002, pet. denied). See also *Brown & Root, Inc. v. Moore*, 92 S.W.3d 848 (Tex. App.—Texarkana 2002, pet. filed); *Ehrhardt v. Elec. & Instrumentation Unlim. of Louisiana*, 220 F. Supp. 2d 649 (E.D. Tex. 2002); *Hall v. Diamond Shamrock Ref. Co.*, 82 S.W.3d 5 (Tex. App.—San Antonio 2001, pet. granted); *R & R Contractors v. Torres*, 88 S.W.3d 685, 708 (Tex. App.—Corpus Christi 2002, no pet.) (“A corporation may not be held liable for punitive damages for gross negligence unless the corporation itself commits gross negligence, authorized or ratified an agent's gross negligence, was grossly negligent in hiring an unfit agent, or committed gross negligence through the actions or inactions of a vice-principal.”).

21. See, e.g., *Central De Fianzas, S.A. v. Bridgefarmer & Assocs., No. CA 3:01-CV-1841-R*, 2002 WL 1477444 (N.D. Tex. July 5, 2002); *Examination Mgmt. Servs., Inc. v. V & P Enters., Inc., No. 3:02-CV-0401-L*, 2002 U.S. Dist. LEXIS 5328 (N.D. Tex. Mar. 27, 2002); *United States v. North Am. Constr. Corp.*, 173 F. Supp. 2d 601, 643-44 (S.D. Tex. 2001);

The Texas decisions addressing the second and third means of imposing liability on individuals acting on behalf of a corporation during this Survey period were much more significant. Because Article 2.21 specifically provides that it does not override any other statutory imposition of individual liability,²² Article 2.21 is not applicable to the second means of imposing liability on individual agents of the corporation, i.e., express statutorily imposed liability.²³ But contrary to a decision by the Corpus Christi Court of Appeals during this Survey period,²⁴ the authors believe that Article 2.21 clearly applies to the third means of imposing liability on individuals—individual participation in a tort committed on behalf of the corporation—as long as the tort complained of arose out of, or relates to, a contractual obligation entered into on behalf of the corporation by the individual upon whom liability is sought to be imposed. Thus, this section of the Survey will begin with an analysis of the cases decided during this Survey period addressing the second means of imposing individual liability on those acting on behalf of a corporation—statutorily imposed liability. Next, those cases decided during the Survey period addressing the third means of imposing liability on individual agents of a corporate entity—personal participation in torts committed on behalf of the corporation—will be discussed.

A. IMPOSING LIABILITY ON CORPORATE OFFICERS, DIRECTORS OR SHAREHOLDERS BY STATUTE

1. *Imposing Liability for Failure to Pay Franchise Taxes: Williams v. Adams*

Section 171.255 of the Texas Tax Code has long imposed personal liability on officers and directors of a corporation whose corporate privileges have been forfeited for failing to file a report or pay a tax “for each debt of the corporation that is created or incurred in [Texas] after the date on which the report, tax, or penalty is due and before the corporate

BMC Software Belg., N.V. v. Marchand, 83 S.W.3d 789 (Tex. 2002); JHC Ventures, L.P. v. Fast Trucking, Inc., 94 S.W.3d 762 (Tex. App.—San Antonio 2002, no pet.); *In re U-Haul Int'l, Inc.*, 87 S.W.3d 653 (Tex. App.—San Antonio 2002, pet. denied); Howell v. Hilton Hotels Corp., 84 S.W.3d 708 (Tex. App.—Houston [1st Dist.] 2002, no pet.); El Puerto De Liverpool, S.A. De C.V. v. Servi Mundo Llantero S.A. De C.V., 82 S.W.3d 622 (Tex. App.—Corpus Christi 2002, pet. dismissed w.o.j.); Pinebrook Props., Ltd. v. Brookhaven Lake Prop. Owners Ass'n, 77 S.W.3d 487 (Tex. App.—Texarkana 2002, pet. denied); Wallace v. Ramon, 82 S.W.3d 501 (Tex. App.—San Antonio 2002, no pet.); Hinkle v. Adams, 74 S.W.3d 189 (Tex. App.—Texarkana 2002, no pet.); Shaw v. Maddox Metal Works, Inc., 73 S.W.3d 472 (Tex. App.—Dallas 2002, no pet.).

22. TEX. BUS. CORP. ACT ANN. art. 2.21(B)(2) (Vernon 2003). Article 2.21(B)(2) states that “nothing contained in this article shall limit the obligation of a holder, . . . or affiliate to an obligee of the corporation when the holder, . . . or affiliate is otherwise liable to the obligee for the obligation under this Act or another applicable statute.” *Id.*

23. *Id.*

24. See Kingston v. Helms, 82 S.W.3d 755 (Tex. App.—Corpus Christi 2002, pet. denied); discussion *infra* Part II.B.

privileges are revived.”²⁵ If applicable, the liability of the corporate officer or director under the Texas Tax Code is the same “as if the director or officer were a partner and the corporation were a partnership.”²⁶ An officer or director can escape personal liability for any debt incurred by the corporation in such circumstances only if the debt was created over the director’s or officer’s objection or without his or her knowledge.²⁷ The purpose of section 171.255 is to encourage payment of franchise taxes by punishing an officer or director who allows the corporation to incur indebtedness while its franchise taxes remain unpaid or its tax reports have not been filed.²⁸

In *Williams v. Adams*,²⁹ the Corpus Christi Court of Appeals decided what it termed a case of first impression in Texas respecting the type of obligations of the corporation that are covered by the term “debt” under the Texas Tax Code.³⁰ June and Robert Williams were both officers of Williams Construction Corporation.³¹ The plaintiff obtained a judgment against the corporation for personal injuries she sustained as the result of the corporation’s negligence.³² The judgment was obtained after the corporation’s charter had been forfeited for failure to pay franchise taxes.³³ After the entry of the judgment against the corporation, the plaintiff brought suit against June and Robert Williams individually, as officers of the corporation, based solely on section 171.255 of the Texas Tax Code.³⁴ The trial court rendered judgment in favor of the plaintiff and against June and Robert Williams on the basis that all of the conditions set forth in section 171.255 had been met.³⁵ June and Robert Williams appealed claiming that (a) section 171.255 does not impose personal liability on officers of a corporation for debts of that corporation arising from unintentional torts; and (b) even if it does, the liability here was incurred before, not “after the date on which the report, tax or penalty [was]

25. TEX. TAX CODE ANN. § 171.255(a) (Vernon 2002 & Supp. 2003); see also Walter A. Schroeder, *Personal Liability of Officers and Directors for Debts of a Texas Corporation*, 25 THE HOUSTON LAWYER 18 (November-December 1987).

26. TEX. TAX CODE ANN. § 171.255(b) (Vernon 2002 & Supp. 2003).

27. *Id.* § 171.255(c). The lack of knowledge element also requires “the exercise of reasonable diligence” by the *director or officer* “to become acquainted with the affairs of the corporation [to the extent it] would not have revealed the intention to create the debt.” *Williams v. Adams*, 74 S.W.3d 437, 440 (Tex. App.—Corpus Christi 2002, pet. denied). Technically, the statute refers to officers and directors in the lead-in to § 171.255(c) and then only refers to directors in the specific sections describing the means of exonerating oneself from liability. The intent to cover officers in the exoneration provisions of § 171.255(c), however, appears clear. *But see* Schroeder, *supra* note 25, at 20.

28. See *Schwab v. Schlumberger Well Surveying Corp.*, 198 S.W.2d 79, 81 (Tex. 1946), cited in *Williams*, 74 S.W.3d at 440.

29. *Williams*, 74 S.W.3d 437.

30. *Id.* at 439.

31. *Id.* at 438.

32. *Id.*

33. *Id.* at 438-39. The negligent act, however, occurred before the corporation forfeited its charter and privileges and while it was apparently current on its taxes and reports. *Id.* at 443.

34. *Id.* at 439.

35. *Id.*

due.”³⁶

After addressing the purpose and construction of section 171.255, the specific statutory language used, and the legislative history, the court concluded that June and Robert Williams were correct in their argument that the statute does not apply to debts arising from tort judgments based on negligence.³⁷ The court reached this conclusion, in large part, because of the provision of the statute exonerating officers or directors from liability when they objected to a debt being incurred or did not know that the debt had been incurred in the exercise of their reasonable obligation to become familiar with the affairs of the corporation.³⁸ According to the court, “[w]hen applied to ‘involuntary debts’ such as a tort judgment—especially one predicated on negligence liability—this provision makes no sense.”³⁹ Rather, “[o]nly by limiting personal liability to debts created through an *actual transaction of business* could officers and directors have a fair and reasonable opportunity to protect themselves against personal liability by disapproving and disavowing such debts.”⁴⁰ According to the court, “failure to adhere to the standards of ordinary prudence” in the conduct of the business of a corporation “and the resultant tort judgment that is assessed” is not part of the “general transacting of corporate business done by the corporation.”⁴¹ Therefore, the court reversed the judgment of the trial court concluding that June and Robert Williams were not personally liable for the negligence judgment rendered against Williams Construction Company at a time when the corporation’s corporate privileges had been forfeited for failure to pay franchise taxes.⁴²

2. *Imposing Liability on Corporate Officers for Violations of the Deceptive Trade Practices Act: Miller v. Keyser*

During the last Survey period the Houston Court of Appeals [First Dis-

36. *Id.* The court did not need to address the second point as to when a liability for negligence results in an incurred debt because the case was decided on the basis that the term “debt” as used in the statute was not intended to cover liabilities arising from unintentional torts. Nevertheless, the court did note that had they needed to reach that issue they would hold that the “debt” “in this case was ‘created or incurred’ on the date” of the negligence, not on the subsequent date that the judgment was actually obtained. *Id.* at 443 n.2.

37. *Id.* at 442.

38. *Id.*

39. *Id.* at 443.

40. *Id.* (quoting *Jonnet v. State*, 877 S.W.2d 520, 532 (Tex. App.—Austin 1994, writ denied) (Jones, J., dissenting)).

41. *Id.*

42. *Id.* The court noted that a different result may be realized in cases involving the administrative assessment of penalties for violations of a statute by a corporation. In those cases there is an ongoing failure to comply with a specific statutory requirement with which the officers and directors were in a position to know the corporation was out of compliance. *Id.* It seems that the court’s “distinction between the failure to comply with a statute and [the] resultant fine that is imposed and the failure to adhere to the standards of ordinary prudence (as in a negligence cause of action), and the resultant tort judgment that is assessed,” could be easily blurred in a case involving a specific course of conduct undertaken by a corporation which the officers and directors knew or should have known was being undertaken in a manner that was negligent. *Id.*

trict] reached its decision in *Keyser v. Miller*,⁴³ wherein it was held that a corporate officer is not personally liable for violations of the Deceptive Trade Practices Act (“DTPA”) unless the corporate officer acted “knowingly.”⁴⁴ We noted in last year’s Corporations Survey that “the court [of appeals] reached this decision notwithstanding that a violation of the DTPA does not require a finding of intent to deceive.”⁴⁵ During this Survey period, the Texas Supreme Court reversed the appellate decision and held that even an innocent corporate agent without any knowledge of the falsity of the statements made on behalf of his or her corporation is personally liable for misrepresentations coming within the purview of the DTPA.⁴⁶

The Texas Supreme Court, in *Miller v. Keyser*,⁴⁷ reached this result because the DTPA is explicit in recognizing a corporate officer or agent as a “person” who may be held liable for false misrepresentations, and the DTPA does not require, as a condition of imposing liability, that the “person” making the false misrepresentation act knowingly or intentionally.⁴⁸ All that is required under the DTPA to hold a corporate officer or agent personally liable for false misrepresentations made on behalf of a corporation is that there is evidence that the corporate officer or agent personally made the misrepresentation complained of and that the “misrepresentation was the producing cause of the consumer’s damages.”⁴⁹ The only consolation offered by the supreme court to the innocent corporate officer or agent is that the DTPA authorizes statutory indemnity and contribution from the corporation.⁵⁰ That is meager comfort, however, to the innocent agent “held liable for unknowingly passing along false company information,” particularly if the “indemnification proves to be not enough protection for agents” because the corporation proves unable to fulfill its indemnification obligation.⁵¹ Noting these problems, the supreme court nevertheless refused “to judicially create an exemption that does not exist in the statute for agents acting solely on behalf of their employers.”⁵² According to the supreme court, if there are indeed problems with the statute, “the Legislature can amend the statute to prevent further mischief.”⁵³ Although not addressed by the

43. *Keyser v. Miller*, 47 S.W.3d 728 (Tex. App.—Houston [1st Dist.] 2001), *rev’d*, *Miller v. Keyser*, 90 S.W.3d 712 (Tex. 2002).

44. West & Treadway, *supra* note 4, at 813-14.

45. *Id.* at 813.

46. *Miller v. Keyser*, 90 S.W.3d 712 (Tex. 2002).

47. *Id.*

48. *See id.* at 715.

49. *Id.*

50. *See id.* at 718.

51. *Id.* at 719.

52. *Id.*

53. *Id.* In another case decided during this Survey period, *Cornman v. State Farm Lloyds*, No. H-01-3266, 2001 U.S. Dist. LEXIS 24472 (S.D. Tex. Nov. 16, 2001), the court similarly found that insurance agents and adjusters are “persons” within the Texas Insurance Code who can be held personally liable for deceptive acts even though committed solely while acting within the scope of their employment on behalf of the insurance company. *Id.* at *12-14 (citing *Liberty Mut. Ins. Co. v. Garrison Contractors, Inc.*, 966 S.W.2d

supreme court, as noted in last year's Corporations Survey, Article 2.21 does not apply to statutorily imposed liability.⁵⁴

B. IMPOSING LIABILITY ON CORPORATE AGENTS FOR THEIR
PERSONAL PARTICIPATION IN A TORT EVEN THOUGH COMMITTED
SOLELY IN THEIR CAPACITY AS A CORPORATE AGENT:

KINGSTON v. HELM

Texas has long recognized that, as a general rule, corporate agents (including officers and directors) are individually liable for their own torts even if committed solely in the scope of their agency on behalf of their corporation.⁵⁵ This Survey period was no exception.⁵⁶ As noted in last year's Corporations Survey, however, the authors believe that Article 2.21 is applicable to such torts to the extent the tort is committed in connection with the execution of a corporate contractual obligation and that, as "affiliates" of the corporation, corporate officers, directors, and shareholders, enjoy the protections afforded by Article 2.21 in such circumstances.⁵⁷ Nevertheless, during this Survey period, the Corpus Christi Court of Appeals in *Kingston v. Helm*⁵⁸ disagreed with the authors' view of the protection provided by Article 2.21.

Kingston involved a claim by the plaintiff against an individual defendant for fraud, negligent misrepresentation and violations of the DTPA.⁵⁹ The claims arose out of the purchase of a townhome by the plaintiff from Greenway Development, Inc., the developer of the townhome and the corporation on whose behalf the defendant was acting as an officer in entering into the contract to sell the townhome to the plaintiff.⁶⁰ At trial, a directed verdict was rendered in favor of Helm, the individual defendant and an officer and shareholder of the corporate defendant, on the basis that the "evidence was insufficient as a matter of law to find Helm liable in his individual capacity."⁶¹

On appeal, the court first discussed the heretofore confusing line of cases addressing whether a corporate agent can be held individually liable

482 (Tex. 1998); *Crown Life Ins. Co. v. Casteel*, 22 S.W.3d 378, 384 (Tex. 2000)). It is surprising given the similarity of the issues presented under the DTPA and the Insurance Code that the Texas Supreme Court did not cite these insurance cases in its analysis of the issues presented under the DTPA in *Keyser*.

54. See generally West & Treadway, *supra* note 4, at 814.

55. See *id.* at 811-16.

56. See, e.g., *McCaskey v. Cont'l Airlines, Inc.*, 159 F. Supp. 2d 562, 577 (S.D. Tex. 2001); *Gore v. Scotland Gold, Inc.*, No. 04-01-00548-CV, 2003 WL 553271, at *4 (Tex. App.—San Antonio Feb. 28, 2003, no pet.); *Hinkle v. Adams*, 74 S.W.3d 189, 194-95 (Tex. App.—Texarkana 2002, no pet.); *Robert L. Crill, Inc. v. Bond*, 76 S.W.3d 411, 423 (Tex. App.—Dallas 2001, pet. denied); *PWS Foods, Inc. v. Taco Bell Corp.*, No. 05-01-01211-CV (Tex. App.—Dallas Apr. 9, 2002, no pet.) (not designated for publication), 2002 Tex. App. LEXIS 2508, at *21.

57. See West & Treadway, *supra* note 4, at 815-16.

58. *Kingston v. Helm*, 82 S.W.3d 755 (Tex. App.—Corpus Christi 2002, pet. denied).

59. *Id.* at 757.

60. *Id.*

61. *Id.* at 758.

for making false misrepresentations under the DTPA solely in his or her capacity as an agent on behalf of the corporation.⁶² While that confusing line of cases has now been clarified by the Texas Supreme Court during this Survey period in *Keyser*, as discussed above,⁶³ *Kingston* was decided prior to *Keyser*. As a result, the *Kingston* court was forced to weed its way through the potentially conflicting case law on the issue.⁶⁴ Without the benefit of *Keyser*, the *Kingston* court nevertheless concluded that an agent could be held individually liable under the DTPA.⁶⁵ It reached this conclusion, however, not on the basis of statutory construction, as the Texas Supreme Court properly did in *Keyser*, but on the traditional rule that corporate agents are always individually liable for their own tortious actions.⁶⁶

The Corpus Christi Court of Appeals next considered the applicability of the two recognized exceptions to the general rule imposing liability on corporate officers who directly participate in a tort on behalf of the corporation.⁶⁷ Last year's Corporations Survey identified those exceptions as: "(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;' 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.'" ⁶⁸ The *Kingston* court quickly concluded that neither of those exceptions applied to a claim of fraud, misrepresentation or a violation of the DTPA.⁶⁹

The appeals court then addressed the potential applicability of Article 2.21 to the claims made against the individual defendant.⁷⁰ The defendant argued that Article 2.21 "effectively eliminated the individual liability for corporate officers and agents who are shareholders in the corporation absent evidence that the corporation itself was specifically used for the purpose of perpetrating a fraud."⁷¹ The court did not believe Article 2.21 could be construed so broadly; rather the court read Article 2.21 as being limited to the fourth category of cases noted above, i.e., cases in which a plaintiff sought to actually pierce the corporate veil.⁷² If the case does not involve a claim of piercing the corporate veil, according

62. *Id.* at 759.

63. *See supra* Part II.A.2.

64. *Kingston*, 82 S.W.3d at 759-61.

65. *Id.* at 761.

66. *Id.*

67. *Id.* at 761-64.

68. West & Treadway, *supra* note 4, at 813.

69. *Kingston*, 82 S.W.3d at 763-64.

70. *Id.* at 764-67.

71. *Id.* at 764.

72. *Id.* at 764-67.

to this court, then Article 2.21 has no applicability.⁷³

In reaching this conclusion, the Corpus Christi Court of Appeals first determined that Article 2.21 by its terms only protects “shareholders” or other owners of the corporation.⁷⁴ Although the court seemingly acknowledged that in addition to shareholders, Article 2.21 also shields “any affiliate thereof or of the corporation,” the court appeared to ignore the phrase “affiliate . . . of the corporation” and focused exclusively on the phrase “affiliate thereof [i.e., of the shareholder].”⁷⁵ Defining “affiliate” as “a person, organization, or establishment associated with another as a subordinate, subsidiary, or member,” the court concluded that the protections afforded by Article 2.21 are limited “to people who own shares or have some relationship with one who owns shares in a corporation.”⁷⁶

Having thus established that the only class of persons entitled to protection under Article 2.21 is a shareholder or other person associated with a shareholder of the corporation, the court next concluded that Article 2.21 is explicit in limiting its protection to suits which seek “to impose individual liability on a corporate shareholder not on the basis of the shareholder’s own actions, but rather on the basis of the shareholder’s mere status as a shareholder.”⁷⁷ The court reaches this conclusion notwithstanding its quoting of the expansive language of Article 2.21 that makes clear that the statute is intended to prevent imposition of liability for corporate obligations (or any matter relating to or arising from those obligations) on any of the protected persons, whether that liability is sought to be imposed because the protected person was “the alter ego of the corporation, or on the basis of actual fraud or constructive fraud, or a sham to perpetrate a fraud, or similar theory.”⁷⁸

Finally, the *Kingston* court then noted that the statute only protects shareholders against “liability for any contractual obligation of the corporation or any matter relating to or arising from the [contractual obligation].”⁷⁹ According to the court, “to define fraud, fraudulent inducement, fraud in a real estate transaction, negligent misrepresentation and DTPA claims as ‘matters relating to or arising from a corporation’s contractual obligation,’ and thus require plaintiffs to meet article 2.21’s requirements in order to hold the individual tortfeasor liable extends the statute beyond its intended and logical reach.”⁸⁰ Consequently, the appellate court reversed the trial court’s directed verdict in favor of the individual defendant, Helm, holding that the plaintiff was “not re-

73. *Id.*

74. *Id.* at 765; see also *Examination Mgmt. Servs., Inc. v. V & P Enters.*, No. 3:02-CV-0401-L, 2002 U.S. Dist. LEXIS 5328, at *12-13 (N.D. Tex. Mar. 27, 2002).

75. *Kingston*, 82 S.W.3d at 765.

76. *Id.*

77. *Id.*

78. *Id.*

79. *Id.* at 766.

80. *Id.*

quired to meet the standard for piercing the corporate veil set forth in article 2.21 in order to impose personal liability upon Helm . . . [because] we do not believe that article 2.21 was intended to insulate corporate agents from individual liability for their own tortious conduct.”⁸¹

Contrary to the Corpus Christi Court of Appeals’ analysis, the authors believe that Article 2.21 does indeed apply to corporate officers and directors, as “affiliate[s] . . . of the corporation,” as well as to shareholders.⁸² Article 2.21 applies to “[a] holder of shares, an owner of any beneficial interest in shares, or a subscriber for shares whose subscription has been accepted, or any affiliate thereof *or of the corporation*.”⁸³ An officer (at least a senior officer) or director of a corporation, particularly one who also owns significant stock of the corporation, should certainly be considered an affiliate of the corporation,⁸⁴ though not necessarily of any individual shareholder. Certainly the common definition of “affiliate” as “a person controlled by or under common control with the other person”⁸⁵ is generally believed to encompass at least executive officers and certainly board members⁸⁶ and is not limited to shareholders; otherwise there would be no need for the addition of the phrase “or of the corporation.” The *Kingston* court’s own definition of “affiliate”, when applied to the corporation as opposed to the shareholders, would clearly cover officers and directors—both are persons “associated with [the corporation] as a subordinate,” because corporate officers and directors, when undertaking duties on behalf of their corporations, are specifically required by Texas law to subordinate their personal interests by not allowing those “interests to prevail over [those] of the corporation.”⁸⁷

Similarly, Article 2.21 cannot be read as only applying to suits seeking to impose liability on a shareholder arising solely as a result of his or her “mere status as a shareholder.” The statute would hardly have been necessary if that was the case because even under *Castleberry*, a shareholder is not held liable based on his or her “mere status” as such, but rather on the basis of his or her conduct in using the corporation.⁸⁸ As noted by the

81. *Id.* at 766-67.

82. See also West & Treadway, *supra* note 4, at 815-16.

83. TEX. BUS. CORP. ACT ANN. art. 2.21(A) (Vernon 2003) (emphasis added).

84. See, e.g., TEX. UTIL. CODE ANN. § 101.003(2)(E) (Vernon 1998 & Supp. 2003); *Camina Servs., Inc. v. Shell Oil Co.*, 816 F. Supp. 1533, 1538 (S.D. Fla. 1992). Indeed, the common definition of “affiliate” is a person who is “closely associated with another.” WEBSTER’S NINTH NEW COLLEGIATE DICTIONARY 61 (9th ed. 1987). See also *Herman v. United Auto., Aircraft & Agric. Implement Workers of Am.*, 59 N.W.2d 475, 478 (Wis. 1953) (The word “affiliate” “literally means a close association”).

85. See 15 U.S.C.A. § 79b(a)(11) (West Supp. 2002); see also TEX. BUS. CORP. ACT ANN. art. 13.02(A)(1) (Vernon 2003).

86. See J. WILLIAM HICKS, *RESALE OF RESTRICTED SECURITIES* 101 (2003) (“A person who serves as a director or executive officer for a corporation . . . is a strong candidate for affiliate status”).

87. *Gearhart Indus., Inc. v. Smith Int’l, Inc.*, 741 F.2d 707, 719 (5th Cir. 1984).

88. See *Castleberry v. Branscum*, 721 S.W.2d 270, 271 (Tex. 1986); see also *Sutton v. Reagan & Gee*, 405 S.W.2d 828, 837 (Tex. Civ. App.—San Antonio 1966, writ ref’d n.r.e.) (“whether or not a shareholder will be insulated from personal liability should depend on the use, or misuse, which *that* shareholder is making of the corporate form”).

Texas Supreme Court in *Castleberry*: “The corporate form normally insulates shareholders, officers, and directors from liability for corporate obligations; but when these individuals abuse the corporate privilege, courts will disregard the corporate fiction and hold them individually liable.”⁸⁹ Indeed, Article 2.21 is explicit in applying to any suit which seeks to hold one of the protected classes of persons liable “on the basis that the holder, owner, subscriber, 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.”⁹⁰

For the same reason, Article 2.21 cannot be read as being limited only to cases involving piercing the corporate veil despite the general acknowledgement that the statute was originally enacted in direct response to *Castleberry*.⁹¹ If that were the case, why refer to “alter ego” completely separate from “actual fraud or constructive fraud, a sham to perpetrate a fraud, or other similar theory?” The phrase “or other similar theory” does not relate only to alter ego—a piercing the corporate veil theory—but to “actual fraud,” “constructive fraud,” and “a sham to perpetrate a fraud.” Remember, too, that the statute was amended twice to further expand its coverage after its original enactment in response to *Castleberry*.⁹²

Finally, to accept the court’s conclusion that “fraud, fraudulent inducement, fraud in a real estate transaction and negligent misrepresentation” are not intended to be covered by the statute, to the extent these causes of action arise in the context of a contractual obligation of a corporation, requires one to simply ignore the plain words in the statute.⁹³ Article 2.21 clearly and unequivocally covers any of the protected class of persons from liability for “any contractual obligation of the corporation or any matter relating to or arising from the obligation.”⁹⁴ Furthermore, Article 2.21 declares that the liability of the protected class of persons covered by the statute for the obligations covered by the statute “is exclusive and preempts any other liability imposed on [such person] for that obligation under common law or otherwise.”⁹⁵ With respect to fraudu-

89. *Castleberry*, 721 S.W.2d at 271.

90. TEX. BUS. CORP. ACT ANN. art. 2.21(A)(2) (Vernon 2003) (emphasis added).

91. See *supra* text accompanying notes 7-10.

92. See also *supra* note 12 and accompanying text.

93. See *Argonaut Ins. Co. v. Baker*, 87 S.W.3d 526, 529 (Tex. 2002) (court construes “a statute, ‘first by looking to the plain and common meaning of the statute’s words’”); *R & R Contractors v. Torres*, 88 S.W.3d 685, 700 (Tex. App.—Corpus Christi 2002, no pet.) (“The court is bound to construe a statute as written and, if possible, ascertain the legislative intent from the language used in the statute.”). As noted previously, the authors do agree with the court’s conclusion that suits under the DTPA do not come within the purview of Article 2.21, because by its express terms, Article 2.21 does not apply to any liability otherwise imposed on a member of the protected class of persons by “another applicable statute.” TEX. BUS. CORP. ACT ANN. art. 2.21(B)(2) (Vernon 2003).

94. TEX. BUS. CORP. ACT ANN. art. 2.21(A)(2) (Vernon 2003).

95. TEX. BUS. CORP. ACT ANN. art. 2.21(B) (Vernon 2003). The exclusivity of the liability of the protected person under Article 2.21 does not however apply when: “(1) the holder, owner, subscriber, or affiliate has expressly assumed, guaranteed, or agreed to be personally liable to the obligee for the obligation; or (2) the holder, owner, subscriber, or

lent inducement in particular, and as noted by the Texas Supreme Court in *Haase v. Glazner*,⁹⁶ “[f]raudulent 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.”⁹⁷ Similarly, the Texas Supreme Court held during this Survey period that the determination of whether there had been fraudulent inducement in connection with a contract that was subject to arbitration must itself be arbitrated pursuant to the terms of that contract since the issue of whether there had been fraudulent inducement was a matter that “arose under or was related” to the contract.⁹⁸ The authors believe that fraud, fraudulent inducement and negligent misrepresentation, when committed by a corporate officer or director in connection with a contractual obligation being entered into by a corporation and in furtherance of and within the scope of the duties of such officer or director on behalf of the corporation, are all “matter[s] relating to or arising from the obligation” as specifically contemplated by Article 2.21.⁹⁹ To hold otherwise vitiates the clear purpose of Article 2.21 in protecting corporate officers, directors and shareholders from individual liability for actions taken on behalf of the corporation in connection with a contractual obligation of the corporation, regardless of the theory on which that liability may be based—unless the plaintiff can prove that the individual officer, director or shareholder “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 [such officer, director or shareholder].”¹⁰⁰

III. SUCCESSOR LIABILITY

While it is

[t]he well settled rule of American jurisdictions . . . that a corporation which purchases the assets of another corporation does not, by

affiliate is otherwise liable to the obligee for the obligation under this Act or another applicable statute.” *Id.*

96. *Haase v. Flazer*, 62 S.W.3d 795 (Tex. 2001).

97. *Id.* at 798.

98. *In re J.D. Edwards World Solutions Co.*, 87 S.W.3d 546 (Tex. 2002). *See also* *Matthews v. Rollins Hudig Hall Co.*, 72 F.3d 50, 54 (7th Cir. 1995) (holding fraudulent inducement claim “relat[ed] to a breach of th[e] Agreement” was subject to arbitration).

99. TEX. BUS. CORP. ACT ANN. art 2.21(A)(2) (Vernon 2003). *See* *Texas-Ohio Gas, Inc. v. Mecom*, 28 S.W.3d 129, 137 (Tex. App.—Texarkana 2000, no pet.) (noting that Article 2.21 limits liability for torts, including fraud, negligent misrepresentation, and fraudulent inducement, “relating to or arising from” contractual obligations). *See also* *Nutmeg Ins. Co. v. Clear Lake City Water Auth.*, 229 F. Supp. 2d 668, 684 (S.D. Tex. 2002) (noting that the words “arising out of” are “broad, general and comprehensive terms effecting broad coverage”); *A & S Council Oil Co. v. Lader*, 56 F.3d 234, 240-41 (D.C. Cir. 1995) (when an alleged illegality “could have affected the price of” a contract, then the claims undoubtedly relate to that contract); *Laserdynamics Inc. v. Acer Am. Corp.*, 209 F.R.D. 388 (S.D. Tex. 2002) (discussing the meaning of a forum selection clause requiring that all “disputes arising out of this agreement” be brought in California); *Interface Group-Nevada, Inc. v. Freeman Decorating Co.*, 473 S.E.2d 573, 575 (Ga. Ct. App. 1996) (stating that “arising from” should cover “almost any causal connection or relationship”).

100. TEX. BUS. CORP. ACT ANN. art 2.21(A)(2) (Vernon 2003).

reason of succeeding to the ownership of property, assume the obligations of the transferor [,] . . . [e]xceptions to this rule exist where (a) the purchasing corporation expressly or impliedly agrees to assume the liabilities of the seller, (b) the transaction amounts to a consolidation or merger of the two companies, (c) the purchasing corporation is merely a continuation of the selling corporation, or (d) the transaction is entered into fraudulently to escape liability.¹⁰¹

As noted in a prior Corporations Survey discussing *Lockheed Martin Corp. v. Gordon*,¹⁰² the Texas legislature has strengthened the general rule of “non-liability” in asset purchases by eliminating exceptions (b) and (c) noted above and strictly limiting exceptions (a) and (d). Specifically, pursuant to Article 5.10(B)(2) of the Texas Business Corporations Act, a purchase of all, or substantially all, of the assets of the seller’s corporation “does not make the acquiring [entity] responsible or liable for any liability or obligation of the selling corporation” unless the acquiring entity assumes the liability or the obligation, or unless another statute expressly provides to the contrary.¹⁰³ Therefore, where Texas law controls the issue, only an express assumption of liability or the application of another statute, such as the fraudulent conveyance statute, would result in the imposition of liability on a purchaser of assets from a corporation.¹⁰⁴

During this Survey period, one federal court had the opportunity to determine when Texas law was applicable to the issue of successor liability.¹⁰⁵ In *White v. Cone-Blanchard Corp.*,¹⁰⁶ the Eastern District of Texas granted a summary judgment motion for the defendants, Park Corporation and its subsidiary Cone-Blanchard Corporation.¹⁰⁷ The defendant corporations were sued as the result of an injury the plaintiff allegedly suffered because of an alleged defect in a Cone-Blanchard Model 11-20 grinding machine that plaintiff was apparently operating at her employer’s plant in Texas.¹⁰⁸ The defendant corporations argued that, while they shared a similar name to and had purchased assets from the corporation which had designed, manufactured, and sold the allegedly defective machine, the plaintiff had sued the wrong party.¹⁰⁹ Apparently, the Cone-Blanchard Machine Company (“CBMC”) had manufactured, sold, and delivered the grinding machine that was the subject of the suit some-

101. *Panther Pumps & Equip. Co. v. Hydrocraft, Inc.*, 566 F.2d 8 (7th Cir. 1977), quoted in *Shapolsky v. Brewton*, 56 S.W.3d 120, 136 n.9 (Tex. App.—Houston [14th Dist.] 2001, pet. denied).

102. *Lockheed Martin Corp. v. Gordon*, 16 S.W.3d 127 (Tex. App.—Houston [1st Dist.] 2000, pet. denied); see West, *supra* note 4, at 1238.

103. TEX. BUS. CORP. ACT ANN. art. 5.10(B)(2) (Vernon 2003).

104. See *Lockheed*, 16 S.W.3d at 139; *Int’l Elevator Co. v. Garcia*, 76 S.W.3d 778, 782 (Tex. App.—Houston [1st Dist.] 2002, no pet.).

105. See *White v. Cone-Blanchard Corp.*, 217 F. Supp. 2d 767 (E.D. Tex. 2002).

106. *Id.*

107. *Id.* at 776.

108. *Id.* at 769.

109. *Id.* at 770.

time in 1981.¹¹⁰

In 1997, CBMC became subject to an involuntary bankruptcy proceeding in the U.S. Bankruptcy Court of the District of Vermont.¹¹¹ As part of those proceedings, certain assets of CBMC were auctioned, and the Park Corporation, through its subsidiary, Blanchard-Windsor Corporation, became the approved buyer of the auctioned assets.¹¹² After the purchase, Blanchard-Windsor's name was changed to Cone-Blanchard Corporation ("CBC").¹¹³ Not all of CBMC's assets were purchased by CBC, and CBMC apparently emerged from bankruptcy and continued as a going concern for a number of years.¹¹⁴ In fact, at the time the original suit was filed, CBMC still existed, but by the time of the appeal, CBMC had become defunct.¹¹⁵ The plaintiff sued both defendants, Park Corporation and CBC, on the theory that "the circumstances surrounding [their] asset purchase from CBMC draped [them] with successor liability with regard to [the] machine."¹¹⁶

The defendant corporations argued that Texas law should govern the issue of whether they were liable as a successor to CBMC, whereas the plaintiff argued that Vermont law should govern.¹¹⁷ The court agreed with the plaintiff.¹¹⁸ According to the court, while applying the "most significant relationship" test to the underlying tort claim would clearly result in the application of Texas law, the "most significant relationship" test must be applied to each issue in the case separately.¹¹⁹ Here, the issue of whether a successor corporation can be liable for the torts of its predecessor in the context of an asset acquisition was an entirely separate issue from the underlying tort action.¹²⁰ Applying the "most significant relationship" test to that issue, the court concluded that Vermont rather than Texas had the most significant relationship because:

CBMC was a Vermont corporation with its principal place of business in Windsor, Vermont The purchase of CBMC's assets occurred in Vermont and all of the assets purchased were located in Vermont at the time of purchase. The purchase agreement between the two companies made Vermont law the choice of law that would govern the purchase agreement. Texas, on the other hand, would appear to have little, if anything, to do with the sale of assets from CBMC to CBC. As such, this court finds Vermont has the most sig-

110. *Id.* at 769-70.

111. *Id.* at 769.

112. *Id.*

113. *Id.*

114. *Id.*

115. *Id.* at 770.

116. *Id.*

117. *Id.* Obviously, the defendants believed Texas law to be more favorable, as Vermont recognizes all of the traditional exceptions to the general rule of "non-liability" in an asset purchase.

118. *Id.* at 771.

119. *Id.*

120. *Id.*

nificant relationship to the issue of succession.¹²¹

While holding Vermont law was applicable to the determination of whether successor liability attached to CBC, the court went on to find that even under Vermont law, CBC was not CBMC's successor.¹²²

IV. DRAFTING CORPORATE CONTRACTS

A. CONTRACT FORMATION—LETTERS OF INTENT

During this Survey period, the Texas courts continued to decide cases where the foremost issue was whether an enforceable agreement even existed. The "common practice . . . of using preliminary letters of intent to outline the basic terms of a corporate acquisition prior to negotiating the definitive purchase agreement"¹²³ was first discussed in the Corporations Survey two years ago as the result of *John Wood Group USA, Inc. v. ICO, Inc.*¹²⁴ In *John Wood*, a Texas court of appeals, faced with a letter agreement which "[did] not address all of the terms and conditions which the parties must agree upon to become binding and consummated" and which the parties expressly agreed was "not binding,"¹²⁵ concluded the seemingly obvious—that the letter agreement at issue was unenforceable.¹²⁶ However, the *John Wood* court nevertheless warned that "a binding contract may be formed if the parties agree on the material terms, even though they leave open other provisions for later negotiation,"¹²⁷ and that "a letter of intent may be binding even though it refers

121. *Id.* A Fifth Circuit case decided under Louisiana choice of law rules during this Survey period also reached a similar result. See *Patin v. Thoroughbred Power Boats, Inc.*, 294 F.3d 640 (5th Cir. 2002).

122. *White*, 217 F. Supp. 2d at 775. *White* also contains an interesting discussion of the meaning of the term "successor." See *id.* at 772. During this Survey period another Texas court also considered this issue in a case involving the interpretation of an insurance policy. See *Duke Energy Field Servs. Assets, L.L.C. v. Nat'l Union Fire Ins. Co.*, 68 S.W.3d 848 (Tex. App.—Texarkana 2002, pet. denied).

123. West, *supra* note 4, at 1233.

124. *John Wood Group, USA, Inc. v. ICO, Inc.*, 26 S.W.3d 12 (Tex. App.—Houston [1st Dist.] 2000, pet. denied). See generally West, *supra* note 4, at 1233-38 (discussing *John Wood* in detail).

125. *John Wood*, 26 S.W.3d at 15. The letter agreement contained the following clause: Binding Effect. This Letter Agreement constitutes a summary of the principal terms and conditions of the understanding which has been reached regarding the sale of certain assets to Purchaser. It does not address all of the terms and conditions which the parties must agree upon to become binding and consummated. The Purchaser, however, does intend to move forward with its due diligence and expects to expend considerable sums to review the Sellers' Business. In consideration thereof, the parties have agreed to make certain covenants of this letter binding upon the parties notwithstanding the fact that not all details of the transactions have been agreed upon. Accordingly, it is understood and agreed that this letter is an expression of the parties' mutual intent and is not binding upon them except for the provisions [regarding the covenant to negotiate in good faith, the prohibition on third-party negotiations, and the agreement of confidentiality].

Id.

126. *Id.* at 20.

127. *Id.* at 19 (citing *Scott v. Ingle Bros. Pac., Inc.*, 489 S.W.2d 554, 555 (Tex. 1972)).

to the drafting of a future, more formal agreement.”¹²⁸

In the following year, two cases expanded on *John Wood*, and both concluded that the issue of whether a letter of intent is binding can be difficult to ascertain (in the absence of a clear statement to that effect) and thus must be left for a jury to determine.¹²⁹ Although one letter of intent did specify that the transaction at issue would be “contingent upon the execution of” another more comprehensive agreement, it never included the explicit statement that the letter was non-binding.¹³⁰ The other letter of intent similarly lacked the phrase “not binding,” even though the letter provided that “subject to [the parties] mutual agreement otherwise, the final documentation of [the] transaction [would] be based upon the [letter] agreement.”¹³¹

This Survey period brought similar issues of whether a preliminary agreement is enforceable and binding upon the parties. In *Bank One, Texas, N.A. v. Apex Energy, LLC*,¹³² Judge Lynn of the Northern District of Texas confirmed that there are two distinct lines of case authority in Texas which determine the enforceability of letters of intent.¹³³ One line concluding that, as a matter of law, a letter of intent is merely an agreement to agree,¹³⁴ the other concluding that the question of whether a letter of intent is an enforceable contract is a fact question for the jury.¹³⁵ The letter at issue in *Bank One* stated that “on or before [a certain date],”

128. *Id.* at 20 (citing *Foreca, S.A. v. GRD Dev. Co.*, 758 S.W.2d 744, 746 (Tex. 1988)).

129. See *Geophysical Micro Computer Applications (Int'l) Ltd. v. Paradigm Geophysical Ltd.*, No. 05-98-02016-CV (Tex. App.—Dallas Oct. 24, 2001, pet. denied) (not designated for publication), 2001 WL 1270795; *Cavalry Invs., L.L.C. v. Sunstar Acceptance Corp.*, No. 05-00-00508-CV (Tex. App.—Dallas Apr. 16, 2001, pet. denied) (not designated for publication), 2001 WL 371545; see also *West and Treadway*, *supra* note 4, at 818-23 (discussing *Calvary Investments* and *Geophysical Micro Computer* in detail).

130. *Cavalry*, 2001 WL 371545, at *7. Specifically, the letter agreement provided 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.” *Id.* at *1.

131. *Geophysical Micro Computer*, 2001 WL 1270795, at *1. The letter agreement at issue stated:

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 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.

Id.

132. *Bank One, Tex., N.A. v. Apex Energy, LLC*, No. 3:00-CV-2160-M, 2001 WL 1335881 (N.D. Tex. Oct. 25, 2001).

133. *Id.* at *2.

134. See *id.* (citing *Dumas v. First Fed. Sav. & Loan Assoc.*, 654 F.2d 359, 360 (5th Cir. 1981); *Weitzman v. Steinberg*, 638 S.W.2d 171, 173 (Tex. App.—Dallas 1982, no writ); *Southwestern States Oil & Gas Co. v. Sovereign Res., Inc.*, 365 S.W.2d 417, 419 (Tex. App.—Dallas 1963, writ ref'd n.r.e.)).

135. *Id.* (citing *Foreca, S.A. v. GRD Dev. Co.*, 758 S.W.2d 744, 746 (Tex. 1988); *Frank B. Hall & Co. v. Buck*, 678 S.W.2d 612, 629 (Tex. App.—Houston [14th Dist.] 1984, writ ref'd n.r.e.); *Hardman v. Dault*, 2 S.W.3d 378, 380 (Tex. App.—San Antonio 1999, no pet.)).

the parties must “enter into a *mutually acceptable* purchase and sale agreement.”¹³⁶ The federal court noted that none of the cases in which a court had determined that the binding nature of a letter agreement was to be determined through a jury had “mutually acceptable” language.¹³⁷ Thus, the presence of such language in the *Bank One* letter instead “conferme[d] that future negotiations were envisioned and connote[d] an understanding that the agreement was still subject to negotiation.”¹³⁸ The court then granted summary judgment to the party who had advocated that the letter of intent was unenforceable.¹³⁹

The San Antonio Court of Appeals reached a similar conclusion in *Oakrock Exploration Co. v. Killam*,¹⁴⁰ a case which involved a letter that purportedly stated the parties mutual understanding regarding certain oil and gas leases.¹⁴¹ However, the crux of the appeals court analysis differed from the previously discussed cases in that the court heavily relied on the proposition that “it is only when an essential term is left open for future negotiation that there is nothing more than an unenforceable agreement to agree.”¹⁴² Since the subject matter of the letter involved oil and gas leases, the appeals court sought to determine whether the letter at issue contained any essential terms specific to oil and gas leases, such as a lease term, a drilling commencement date, or royalty payment amounts.¹⁴³ The court found that the letter did not contain such essential terms of a typical oil and gas lease, and thus found the letter unenforceable as a matter of law.¹⁴⁴

However, in *West Beach Marina, Ltd. v. Erdeljac*,¹⁴⁵ the Austin Court of Appeals was not convinced, as a matter of law, that the preliminary agreement at issue indicated a lack of intent by the contracting parties to

136. *Id.* (emphasis added).

137. *Id.*

138. *Id.* (citing *Dumas*, 654 F.2d at 360).

139. *Id.* at *3.

140. *Oakrock Exploration Co. v. Killam*, 87 S.W.3d 685 (Tex. App.—San Antonio 2002, pet. denied).

141. *Id.* at 687.

142. *Id.* at 690 (citing *T.O. Stanley Boot Co. v. Bank of El Paso*, 847 S.W.2d 218, 221 (Tex. 1992); *Scott v. Ingle Bros. Pac., Inc.*, 489 S.W.2d 554, 555 (Tex. 1972); *Komet v. Graves*, 40 S.W.3d 596, 602 (Tex. App.—San Antonio 2001, no pet.); *Texas Oil Co. v. Teneeco Inc.*, 917 S.W.2d 826, 830 (Tex. App.—Houston [14th Dist.] 1994), *rev'd on other grounds sub nom. Morgan Stanley & Co. v. Texas Oil Co.*, 958 S.W.2d 178 (Tex. 1997).

143. *Oakrock Exploration Co.*, 87 S.W.3d at 690-91. The court also listed the following as essential terms to an oil and gas lease: time and amount of payments in lieu of drilling operations and the character, extent and duration of the rights to the oil and gas in place. *Id.*

144. *Id.* at 691; *see also* *Beal Bank, S.S.B. v. Schleider*, No. 14-01-00969-CV, 2003 WL 124243, at *8 (Tex. App.—Houston [14th Dist.] January 16, 2003, no pet.) (failure of parties to agree on length of extension, rate of interest, or amount and number of payments made purported modification of promissory note unenforceable as matter of law); *but see* *Lerer v. Lerer*, No. 05-02-00124-CV (Tex. App.—Dallas Nov. 26, 2002, pet. filed) (not designated for publication), 2002 WL 31656109 (fact that settlement agreement contemplated drafting of “more formal settlement documents” and the parties continued to negotiate on non-essential terms does not render agreement unenforceable).

145. *West Beach Marina, Ltd., v. Erdeljac*, No. 03-01-00475-CV, 2002 WL 31718136 (Tex. App.—Austin Dec. 5, 2002, no pet. h.).

be bound and thus concluded that the trial court's decision to have a jury determine the issue of enforceability was correct.¹⁴⁶ *West Beach* involved a preliminary settlement agreement which included the following provision: "The parties recognize that this agreement reflects a summary . . . and that there will be additional matters to be resolved . . . which [will] be ultimately reduced to a formal settlement agreement."¹⁴⁷ Addressing the appellant's argument that the preliminary agreement's inclusion of this language contemplating a latter agreement after further negotiation demonstrates unenforceability, the appeals court emphasized that an enforceable agreement can occur even if the parties "agree on certain contract terms and leave others for later negotiation."¹⁴⁸ Moreover, after comparing *Foreca, S.A. v. GRD Development Co.*,¹⁴⁹ in which the Texas Supreme Court concluded that the language "subject to legal documentation" did not conclusively establish a non-binding agreement,¹⁵⁰ with *John Wood*,¹⁵¹ in which the Houston Court of Appeals concluded that the language "not binding" *did* conclusively establish a non-binding agreement,¹⁵² the Austin Court of Appeals reasoned that the *West Beach Marina* language was "more closely analogous to *Foreca*['s language]" in that both "lack[ed] an expression of clear intent *not* to be bound."¹⁵³ Thus, the question of the *West Beach Marina* parties' intent was "le[ft] open" and only a jury could decide whether the parties in fact intended to be bound.¹⁵⁴

146. *Id.* at *1, *7.

147. *Id.* at *4.

148. *Id.* at *5 (citing *T.O. Stanley Boot Co. v. Bank of El Paso*, 847 S.W.2d 218, 221 (Tex. 1992); *Scott v. Ingle Bros. Pac., Inc.*, 489 S.W.2d 554, 555 (Tex. 1972)). Moreover, specifically in the context of a settlement agreement, there is "no support . . . that failure to settle all disputed issues renders a mediation agreement unenforceable." *Id.* at *6.

149. *Foreca, S.A. v. GRD Dev. Co.*, 758 S.W.2d 744 (Tex. 1988).

150. *See West Beach Marina*, 2002 WL 31718139, at *5 (citing *Foreca*, 758 S.W.2d at 746).

151. *John Wood Group USA, Inc. v. ICO, Inc.*, 26 S.W.3d 12 (Tex. App.—Houston [1st Dist.] 2000, pet. denied). *See also supra* text accompanying notes 123-128 (discussing *John Wood*).

152. *See West Beach Marina*, 2002 WL 31718139, at *5 (citing *John Wood*, 26 S.W.3d at 15); *but cf.* *Shell Oil Prods. Co. v. Main St. Ventures, L.L.C.*, 90 S.W.3d 375, 382 (Tex. App.—Dallas 2002, pet. abated) (even though the specific language "non-binding" is absent, court concludes in dicta that a letter of intent was nevertheless "non-binding" where it states: (i) "the parties would only become bound if definitive agreements are signed by them," (ii) only the definitive agreement, "when, as and if executed and delivered, would have any legal effect," and (iii) "either party may terminate negotiations without incurring any obligation whatsoever to the other party").

153. *West Beach Marina*, 2002 WL 31718139, at *6 (emphasis in original). *See also* *Electronic Bankcard Sys., Inc. v. Retriever Indus., Inc.*, No. 01-01-00240-CV (Tex. App.—Houston [14th Dist.] January 30, 2003, no pet.) (not designated for publication), 2003 WL 204717, at *5 (conflicting language in letter of intent).

154. *See id.*; *see also* *NTBS Storage & Retrieval, Inc. v. Kardex Sys., Inc.*, No. 3:98-CV-0996-M, 2001 U.S. Dist. LEXIS 24606 (N.D. Tex. Feb. 12, 2001). In *NTBS*, the Northern District of Texas was similarly not convinced that the letter at issue was merely an "agreement to agree" and also concluded that a judicial decision establishing that no contract existed would be improper. *Id.* at *12. Although it was undisputed that a formal agreement was never executed, the litigating parties disagreed as to the enforceability of a letter, which on its face failed to address a certain material term and also expressly contemplated

The message from all of these cases to the corporate practitioner is clear: A preliminary agreement contemplating more formal documentation, or even the negotiation of additional terms and conditions, may be binding and enforceable, notwithstanding the failure of the parties to enter into more formal documentation or to negotiate the additional terms and conditions.¹⁵⁵ If parties intend that such a preliminary agreement not be binding, corporate counsel should so articulate in clear and explicit terms.¹⁵⁶

B. THE SANCTITY OF CONTRACT VS. CLAIMS OF FRAUDULENT
INDUCEMENT: *DRC PARTS & ACCESSORIES, L.L.C.*
v. VM MOTORI, S.P.A.

Corporate practitioners rely on the sanctity of the written word when they negotiate contracts on their clients' behalf. Similarly, corporate attorneys rely on documents as written when advising their client on how to comply with the terms of an agreement. This Survey period, the Texas courts re-confirmed long-established contract construction principles that emphasize the sanctity of the contract as written: The primary concern of a court in construing a written contract is to ascertain the true intent of the parties as expressed in the instrument.¹⁵⁷ Where contract language is clear and definite, ambiguity does not exist and a court must apply plain

the negotiation and execution of another, more formal, agreement in the future. *Id.* at *12-13. Because the court did not find evidence in the record showing the fact that negotiations had taken place after the letter was written (thereby evidencing an intent that the existing letter agreement was intended to be binding), the court concluded that a fact issue existed as to whether the letter constituted a binding agreement. *Id.* at *16.

155. Applying New York law, the Second Circuit Court of Appeals' *Adjustrite Sys., Inc. v. GAB Bus. Servs., Inc.*, 145 F.3d 543 (2d Cir. 1998), is particularly instructive as to the difference between a "binding preliminary agreement" and an "unenforceable agreement to agree." See generally Thomas C. Homburger & James R. Schueller, *Letters of Intent—A Trap for the Unwary*, 37 REAL PROP. PROB. & TR. J. 509 (2002).

156. In *Papas Telecasting Cos. v. Lee Enterprises, Inc.*, No. 08-00-00394-CV (Tex. App.—El Paso, Jan. 17, 2002, pet. denied) (not designated for publication), 2002 WL 59693, another case decided during this Survey period, the El Paso Court of Appeals had to resolve a dispute as to whether a binding agreement existed. *Id.* at *4. A letter of intent for the purchase and sale of a television station had been executed, which specifically provided that the letter did not constitute a binding agreement, but merely an agreement to enter into a definitive asset purchase agreement that would include among other documents, certain schedules and exhibits. *Id.* at *1. Although the schedules had not been completed, the president of one of the parties insisted that each party sign the asset purchase agreement before he left the country for an extended vacation. *Id.* at *2. Subsequently, each party executed the asset purchase agreement without the schedules attached. *Id.* At trial, it was disputed whether counsel for both parties had agreed that although the purchase agreement was to be signed, it would not become effective until the relevant schedules were completed. *Id.* at *4. The appeals court affirmed the trial court decision that the evidence conclusively established that the parties did in fact agree that the asset purchase agreement would not become binding until completion of the schedules, notwithstanding the fact that the agreement had been signed. *Id.* at *5.

157. See, e.g., *Bio-Medical Applications of Texas, Inc. v. Medical Mgmt., P.A.*, 198 F. Supp. 2d 849 (E.D. Tex. 2002); *ASI Techs., Inc. v. Johnson Equip. Co.*, 75 S.W.3d 545 (Tex. App.—San Antonio 2002, pet. denied); *Cone v. Fagadau Energy Corp.*, 68 S.W.3d 147 (Tex. App.—Eastland 2001, pet. denied); *Universal Health Servs., Inc. v. Thompson*, 63 S.W.3d 537 (Tex. App.—Austin 2001, pet. granted).

language as a matter of law.¹⁵⁸ The objective intent of the parties as expressed in the writing controls the contract's interpretation and the contract must be enforced as written.¹⁵⁹ In construing a contract, a court should consider each part with every other part and presume the parties intend every clause to have some effect.¹⁶⁰ As one court this Survey period firmly stated:

Parties to the contract are considered masters of their own choices. They are entitled to select what terms and provisions to include in a contract before executing it. And, in so choosing, each is entitled to rely upon the words selected to demarcate their respective obligations and rights. In short, the parties strike the deal they choose to strike and, thus, voluntarily bind themselves in the manner they choose . . . *a deal is a deal*.¹⁶¹

However, this Survey period also brought forth a startling case that seems to endanger such oft-repeated legal principles, and in effect, should cause corporate attorneys to reconsider if they have taken such principles for granted.

*DRC Parts & Accessories, L.L.C. v. VM Motori, S.P.A.*¹⁶² involved a dispute by two contracting parties over the interpretation of a seemingly unambiguous word in an agreement.¹⁶³ VM Motori, S.P.A. ("VM"), an Italian manufacturer and seller of industrial diesel engines, contracted

158. See, e.g., *International Turbine Servs., Inc. v. VASP Brazilian Airlines*, 278 F.3d 494 (5th Cir. 2002); *Gonzales v. Columbia Hosp. at Medical City Dallas Subsidiary, L.P.*, 207 F. Supp. 2d 570 (N.D. Tex. 2002); *Petrocon Eng'g, Inc. v. MAC Equip., Inc.*, 199 F. Supp. 2d 599 (E.D. Tex. 2002); *Decorative Ctr. of Houston, L.P. v. Direct Response Publ'ns, Inc.*, 208 F. Supp. 2d 719 (S.D. Tex. 2002); *City of Ranger v. Morton Valley Water Supply Corp.*, 79 S.W.3d 776 (Tex. App.—Eastland 2002, pet. denied); *CU Lloyd's of Texas v. Main Street Homes, Inc.*, 79 S.W.3d 687 (Tex. App.—Austin 2002, no pet.); *Farmers & Merchs. State Bank of Krum v. Reece Supply Co.*, 79 S.W.3d 615 (Tex. App.—Eastland 2002, pet. denied); *O'Kehie v. Harris Leasing Co.*, 80 S.W.3d 316 (Tex. App.—Texarkana 2002, no pet.); *State v. Japage P'ship*, 80 S.W.3d 618 (Tex. App.—Houston [1st Dist.] 2002, no pet.); *W.W. Laubach Trust/Georgetown Corp. v. Georgetown Corp./W.W. Laubach Trust*, 80 S.W.3d 149 (Tex. App.—Austin 2002, pet. denied).

159. See, e.g., *Geosouthern Energy Corp. v. Chesapeake Operating Inc.*, 274 F.3d 1017 (5th Cir. 2001); *Santleben v. Cont'l Airlines, Inc.*, 178 F. Supp. 2d 752 (S.D. Tex. 2001); *In re Thornburg*, 277 B.R. 719 (Bankr. E.D. Tex. 2002); *Hance, Scarborough, Wright, Ginsberg & Brusilow, L.L.P. v. Kincaid*, 70 S.W.3d 907 (Tex. App.—Amarillo 2002, pet. denied); *Faust v. Pumpco, Inc.*, 57 S.W.3d 620 (Tex. App.—Texarkana 2001, pet. denied); *Jameston Partners, L.P. v. City of Fort Worth*, 83 S.W.3d 376 (Tex. App.—Fort Worth 2002, pet. denied); *Sabre Oil & Gas Corp. v. Gibson*, 72 S.W.3d 812 (Tex. App.—Eastland 2002, pet. denied); *EOG Res., Inc. v. Hanson Prod. Co.*, 94 S.W.3d 697 (Tex. App.—San Antonio 2002, no pet.); *State Farm Lloyds v. Durbin*, No. 05-00-02108-CV (Tex. App.—Dallas March 15, 2002, no pet.) (not designated for publication), 2002 WL 398801.

160. See, e.g., *Hollomon v. O. Mustad & Sons, Inc.*, 196 F. Supp. 2d 450 (E.D. Tex. 2002); *Automobile Ins. Co. of Hartford, Conn. v. Young*, 85 S.W.3d 334 (Tex. App.—Amarillo 2002, no pet.); *Snyder v. Cowell*, No. 08-01-00186-CV (Tex. App.—El Paso Jan. 10, 2002, no pet.) (not designated for publication), 2002 WL 27105.

161. *ASI Techs., Inc. v. Johnson Equip. Co.*, 75 S.W.3d 545, 549 (Tex. App.—San Antonio 2002, pet. denied) (citing *Cross Timbers Oil Co. v. Exxon Corp.*, 22 S.W.3d 24, 26 (Tex. App.—Amarillo 2000, no pet.) (emphasis added)).

162. *DRC Parts & Accessories, L.L.C. v. VM Motori, S.P.A.*, No. 14-01-00507-CV, 2002 WL 31318550 (Tex. App.—Houston [14th Dist.], Oct. 17, 2002, no pet.).

163. *Id.* at *1.

with DRC Parts and Accessories, L.L.C. (“DRC”) to purchase and distribute its products in North America.¹⁶⁴ VM was later purchased by an American company with an extensive network of representatives, and thus the need for VM to contract with DRC decreased substantially.¹⁶⁵ However, due to the two parties’ long history, VM sought to continue its relationship with DRC and subsequently, both entered into a new agreement.¹⁶⁶ The agreement stated, “VM . . . grants on a *non-exclusive* basis . . . [to] DRC . . . the right to purchase and sell VM [products].”¹⁶⁷ Thereafter, DRC filed suit against VM for breach of contract, alleging that the contract had in fact given it an *exclusive* right to sell DRC products.¹⁶⁸ In the alternative, DRC alleged that if the contract did only grant DRC a non-exclusive right, VM had committed fraud in inducing DRC to enter into the contract by misrepresenting that DRC’s right would be exclusive.¹⁶⁹ After the trial court granted DRC’s motion for summary judgment in its favor, VM appealed to the Houston Court of Appeals.¹⁷⁰

The court of appeals began its analysis by stating that DRC was arguing that there existed two reasonable interpretations for the term “non-exclusive:” one interpretation defining the term to mean non-exclusive, while the other interpretation defined the term to mean exactly the opposite—exclusive.¹⁷¹ Obviously, the court disagreed with DRC’s proposition.¹⁷² Noting that in order for an ambiguity to exist in a contract, both interpretations must be reasonable,¹⁷³ the appeals court found that under the plain language of the agreement, DRC was not an exclusive dealer of VM products.¹⁷⁴ Accordingly, VM did not breach the agreement.¹⁷⁵ So far, so good. Unfortunately, the appeals court did not end its analysis with that simple conclusion.

In the alternative, DRC also alleged that it had been fraudulently induced to enter into the agreement by VM falsely representing that the agreement actually gave DRC an exclusive right.¹⁷⁶ In response, VM, relying on case law support, asserted that fraud can never be predicated on alleged misrepresentations that conflict with the written terms of a contract.¹⁷⁷ After chronicling case law on fraud in the inducement, the appeals court shockingly concluded that notwithstanding the clarity of the written agreement, sufficient evidence nonetheless existed to raise a fact

164. *Id.*

165. *Id.*

166. *Id.*

167. *Id.* (emphasis added).

168. *Id.*

169. *Id.*

170. *Id.*

171. *Id.* at *1, *3.

172. *Id.* at *3.

173. *Id.* (citing *Nat’l Union Fire Ins. Co. v. CBI Indus., Inc.*, 907 S.W.2d 517, 520 (Tex. 1995); *Glover v. Nat’l Ins. Underwriters*, 545 S.W.2d 755, 761 (Tex. 1977)).

174. *See DRC*, 2002 WL 31318550, at *3.

175. *Id.*

176. *Id.* at *1.

177. *Id.* at *4 (citing *Town North Nat’l Bank v. Broadus*, 569 S.W.2d 489 (Tex. 1978)).

issue as to whether DRC was fraudulently induced and reversed the trial court's decision.¹⁷⁸

The appeals court first admitted that without the long-established principle that extrinsic evidence is not admissible when a contract is clear on its face,¹⁷⁹ "the solemnity of contracts would be extinguished."¹⁸⁰ However, the court continued, "where one party's assent is induced by deception, no contract exists because there has been no mutuality of agreement."¹⁸¹ And, because such fraud can only be shown by extrinsic evidence, such evidence is thus admissible.¹⁸²

Distinguishing the instant case from *Town North National Bank v. Broaddus*,¹⁸³ a Texas Supreme Court case that cited to an appellate case, which warned that the admissibility of extrinsic evidence would "destroy the parol evidence rule[the ban on the admissibility of such evidence] altogether,"¹⁸⁴ the Houston Court of Appeals noted that DRC was asserting fraud as a cause of action in which a plaintiff seeks tort damages; DRC was not asserting fraud as an affirmative defense in which a plaintiff seeks to vary the terms of a contract.¹⁸⁵ In effect, the parol evidence rule would not be directly implicated, as "the legal duty not to fraudulently procure a contract is separate and independent from the duties established by the

178. *Id.* at *6. *But see* Suttles v. Kastleman, No. 03-01-00719-CV (Tex. App.—Austin July 26, 2002, no pet.) (not designated for publication), 2002 WL 1729519; Carter v. Plano Prairie Partners, Ltd., No. 05-01-00179-CV (Tex. App.—Dallas Apr. 30, 2002, no pet.) (not designated for publication), 2002 WL 775033 (both decisions decided during this Survey period affirmed the trial court's grant of summary judgment against the party seeking a claim of fraudulent inducement).

179. *See DRC*, 2002 WL 31318550, at *4 (citing *Marburger v. Seminole Pipeline Co.*, 957 S.W.2d 82, 86 (Tex. App.—Houston [14th Dist.] 1997, pet. denied)).

180. *Id.*

181. *Id.*

182. *See id.* (citing *Marburger*, 957 S.W.2d at 86).

183. *Town North Nat'l Bank v. Broaddus*, 569 S.W.2d 489 (Tex. 1978).

184. *Mitcham v. London*, 110 S.W.2d 140, 142 (Tex. Civ. App.—Austin 1937, no writ). In *Town North*, the plaintiff sued three co-makers for recovery on a promissory note. *Town North*, 569 S.W.2d at 490. Two of the co-makers alleged that they were fraudulently induced into signing the note by the plaintiff's representation so that it would look solely to the third co-maker for payment of the loan. *Id.* at 490-491. Relying upon the appellate case *Mitcham v. London*, the Texas Supreme Court held that extrinsic evidence of fraud is admissible to avoid a promissory note only when the evidence shows "some sort of trick, artifice or device was employed by the payee in addition to his representation to the maker that he would not be liable." *Town North*, 569 S.W.3d at 493. Because *Town North* involved a promissory note and the fraud at issue was asserted as an affirmative defense, the DRC court distinguished *Town North* as "narrow" and thus inapplicable to the facts of *DRC*. *DRC*, 2002 WL 31318550, at *5.

185. *See also* Suttles v. Kastleman, No. 03-01-00719-CV (Tex. App.—Austin July 26, 2002, no pet.) (not designated for publication), 2002 WL 1729519; Carter v. Plano Prairie Partners, Ltd., No. 05-01-00179-CV (Tex. App.—Dallas Apr. 30, 2002, no pet.) (not designated for publication), 2002 WL 775033 (both cases decided during this Survey period in which the defendants asserted fraudulent inducement as an affirmative defense); *cf.* John v. Marshall Health Servs., Inc., 91 S.W.3d 446 (Tex. App.—Texarkana 2002, pet. filed); Columbia v. Cottey, 72 S.W.3d 735 (Tex. App.—Waco 2002, no pet.) (both cases decided this Survey period in which the plaintiff alleged fraudulent inducement as a cause of action).

contract itself.”¹⁸⁶ Thus, parol evidence could be properly admitted.¹⁸⁷ Subsequently, the court of appeals found sufficient evidence in the form of letters, memoranda, and affidavit testimony that raised a fact issue as to whether DRC was fraudulently induced by VM to execute the agreement.¹⁸⁸

Judge Edelman wrote a dissenting opinion which encapsulates the arguments on why this case was wrongly decided.¹⁸⁹ These arguments, with which the authors agree, are summarized as follows: The appeals court essentially concludes that a claim of fraudulent inducement in which a plaintiff relies on a statement that directly contradicts the plain language of contract overrides such plain language.¹⁹⁰ In coming to this conclusion, the appeals court forgets that one of the elements of a fraud claim is that the plaintiff has to actually and *justifiably* rely on the alleged misrepresentation.¹⁹¹ This is because a party to an arm’s length transaction, as most every corporate agreement is, is presumed to exercise ordinary care and reasonable diligence and the failure to do so is not an excuse to allege fraud.¹⁹² In the instant case, it is difficult for the authors to ascertain how DRC would be justified in relying on VM’s alleged misrepresentation when the language of the agreement was so apparent and unambiguous.

The principle that in the absence of trickery or deceit, reliance on a misrepresentation that directly contradicts the express terms of a written agreement is not justified, and thus cannot support a claim for fraud in the inducement, has been clearly articulated by the Texas Supreme Court.¹⁹³ As the *DRC* dissent notes, this principle is also supported by practical considerations and ignoring it only results in a questionable environment for any corporate practitioner:

If, as the majority holds, a claim for fraudulent inducement can lie where the alleged misrepresentation directly contradicts the written contract, then the contract ceases to establish the rights and obligations of the parties and instead merely provides a mechanism to hold a party liable for complying with it as well as not complying with it. Under those circumstances, what is the use of entering into written contracts at all, or for that matter, providing courts for the purpose

186. *DRC*, 2002 WL 31318550, at *5 (citing *Formosa Plastics Corp. USA v. Presidio Eng’rs & Contractors, Inc.*, 960 S.W.2d 41, 46 (Tex. 1998)).

187. *Id.*

188. *Id.* The requirements for a fraud cause of action are: (1) a material misrepresentation that is false, (2) the misrepresentation was either known to be false when made or was asserted without knowledge of its truth, (3) the misrepresentation was intended to be acted upon, (4) the misrepresentation was in fact relied upon, and (5) the misrepresentation caused injury. See *Formosa Plastics*, 960 S.W.2d at 47.

189. See *DRC*, 2002 WL 31318550, at *7 (Edelman, R., dissenting).

190. See *id.*

191. See *id.* (citing *Ernst & Young, L.L.P. v. Pac. Mut. Life Ins. Co.*, 51 S.W.3d 573, 577 (Tex. 2001); RESTATEMENT (SECOND) OF TORTS § 537 (1977)).

192. See *DRC*, 2002 WL 31318550, at *7 (citing *Thigpen v. Locke*, 363 S.W.2d 247, 251 (Tex. 1962)).

193. *Id.* (citing *Town North Nat’l Bank v. Broadus*, 569 S.W.2d 489 (Tex. 1978)).

of not enforcing, and thereby defeating, them?¹⁹⁴

Even though the majority of the Houston Court of Appeals seems to negate well-established contract law concepts, buried at the end of its opinion lies good advice, or at least a reminder, for corporate attorneys. Although the court concludes that the merger clause contained in the *DRC* agreement did not waive a claim of fraudulent inducement,¹⁹⁵ it states in dicta that a proper “release that clearly expresses the parties’ intent to waive fraudulent inducement claims, or one that disclaims reliance on representations about specific matters in dispute, can preclude a claim of fraudulent inducement.”¹⁹⁶ Therefore, when negotiating corporate agreements,¹⁹⁷ practitioners should remember to include an explicitly-stated waiver and disclaimer to minimize the risk that the other party will later assert a claim based on something that goes beyond the four

194. *Id.*

195. *See id.* at *6. The merger clause in *DRC* provides: “The present agreement substitutes and invalidates any other former agreement.” *Id.*

196. *Id.* (citing *Schlumberger Tech. Corp. v. Swanson*, 959 S.W.2d 171, 181 (Tex. 1997)). In *Schlumberger*, the Texas Supreme Court found the following facts to be significant in concluding that the release provision at issue was effective to disclaim fraudulent inducement: (1) the parties were dealing in an arm’s length transaction, (2) both parties were represented by highly competent legal counsel during the negotiations for the terms of the release itself, (3) both parties were knowledgeable and sophisticated business players, and (4) the terms of the release “in clear language . . . unequivocally disclaimed reliance.” *Schlumberger*, 959 S.W.2d at 180.

197. Regarding the law of contractually disclaiming fraudulent inducement claims, both the New York and Delaware courts have arrived at similar conclusions. New York law holds that a clause, which states that the party has not relied on any statement or representation not in the contract, prevents an allegation of fraud in the inducement. *See Danann Realty Corp. v. Harris*, 57 N.E.2d 597 (N.Y. 1959). In a more recent case, *Morse Diesel, Inc. v. Fidelity & Deposit Co. of Md.*, No. 86 CIV. 1494 (PKL), 1990 WL 52266 (S.D.N.Y. Apr. 19, 1990), a federal court cited *Danann* while stating that “[i]t has long been the law in New York State that a party may not allege fraudulent misrepresentation or inducement, where there is a specific disclaimer of reliance.” *Id.* at *3. Moreover, the court noted that under the *Danann* rule, parol evidence is not admissible in the face of an explicit disclaimer clause. *Id.* at *4. However, because *Danann* had “been criticized as encouraging the use of boilerplate language in contract formation,” New York’s highest court had recently “moved away from the rigid requirement that plaintiff’s disclaimer of reliance be explicit . . . [and instead,] has looked to the contract relationship as a whole to determine if the plaintiff, by words or actions, has disclaimed reliance.” *Id.* In effect, this has led to a more liberal interpretation of *Danann*. *See, e.g., Citibank, N.A. v. Plapinger*, 485 N.E.2d 974 (N.Y. 1985) (holding that a plaintiff could not allege fraudulent inducement to a contract, which explicitly stated that the guarantee contained therein was “absolute and unconditional”); *Bonda v. LNR Props.*, 547 N.Y.S.2d 744 (N.Y. App. Div. 1989) (holding that where, at the time of contract formation, plaintiff had refused to permit inclusion of a specific representation into the contract, plaintiff could not later maintain an action for fraudulent misrepresentation on that same information). Delaware has found certain factors, similar to the ones listed in Texas’ *Schlumberger*, 959 S.W.2d 171, persuasive in concluding that explicit contract disclaimers can bar fraudulent inducement claims. *See Great Lakes Chem. Corp. v. Pharmacia Corp.*, 788 A.2d 544 (Del. Ch. 2001). In *Great Lakes*, the Delaware Court of Chancery noted that even though there existed Delaware cases which prohibited the use of contract disclaimers to absolve claims of fraud, those cases were distinguishable in that each involved “simple real estate contracts having boilerplate, un-negotiated disclaimer language.” *Id.* at 555 (citing *Norton v. Poplos*, 443 A.2d 1 (Del. 1982)). In contrast, *Great Lakes* involved “two highly sophisticated parties, assisted by industry consultants and experienced legal counsel, [who] entered into carefully negotiated disclaimer language after months of extensive due diligence.” *Id.*

corners of the contract.¹⁹⁸ Practitioners should especially do so when at least one Texas court is willing to validate such claims.¹⁹⁹

C. SPECIAL CORPORATE CONTRACT INTERPRETATION ISSUES

1. *Interpretation of Best Efforts Clauses: Herrmann Holdings, Ltd. v. Lucent Technologies, Inc.*

When parties seeking to enter into an agreement cannot quite define certain obligations to one another, often corporate counsel suggest language like “best efforts” to assist in characterizing the parties’ duties. Although the term “best efforts” is obviously indefinite,²⁰⁰ it is frequently

198. See, e.g., *Shell Oil Prods. Co. v. Main St. Ventures, L.L.C.*, 90 S.W.3d 375 (Tex. App.—Dallas 2002, pet. abated); *John v. Marshall Health Servs., Inc.*, 91 S.W.3d 446 (Tex. App.—Texarkana 2002, pet. denied). In this Survey period’s, *Shell Oil*, the Dallas Court of Appeals, distinguishing the situation in which a party enters into a binding contract which specifically cautions against relying on verbal statements which contradict the agreement, concluded that the following language in a non-binding letter of intent did not preclude a plaintiff’s claim of fraud: “[O]nly the representations and warranties and other terms and conditions of the [definitive agreement], when, as and if executed and delivered, would have any legal effect At any time prior to the execution of the [definitive agreement], either party may terminate negotiations without incurring any obligation whatsoever to the other party.” *Shell Oil*, 90 S.W.3d at 382. Similarly, *John*, also decided this Survey period, involved a defendant in a fraudulent inducement action seeking to rely on the following contract provision as a disclaimer: “This Agreement . . . constitute[s] the entire agreement between the parties regarding the subject matter thereof and supercede[s] all prior contemporaneous discussions, representations, correspondence and agreements, [] whether oral or written, pertaining thereto.” *John*, 2002 WL 31487882, at *2. The court found the language to be too unspecific and “more like ‘boilerplate’ contract language,” and thus, the plaintiff had not disclaimed or released any claim for fraudulent inducement. *Id.* at *3. Compare this result to *Schlumberger*, 959 S.W.2d 171, in which the Texas Supreme Court concluded that the following disclaimer of reliance was binding and, as a matter of law, precluded a claim of fraudulent inducement: [Plaintiffs] release all

causes of action of whatsoever nature, or any other legal theory arising out of circumstances [regarding the parties’ disagreement (in this case, the valuation of a certain joint venture)], from any and all liability damages of any kind known or unknown, whether in contract or tort [Plaintiffs] expressly warrant[] and represent[] and do[] hereby state . . . and represent . . . that no promise or agreement which is not herein expressed has been made to him or her in executing this release, and that none of us is relying upon any statement or representation of any agent of the parties being released hereby. Each of us is relying on his or her own judgment and each has been represented by . . . legal counsel in this matter. The aforesaid legal counsel has read and explained to each of us the entire contents of this Release in Full, as well as the legal consequences of this Release.

Id. at 180 (emphasis in original).

199. Another case decided recently, *Joppich v. 1464-Eight, Ltd.*, No. 01-01-00742-CV, 2002 WL 31837868 (Tex. App.—Houston [1st Dist.] December 19, 2002, pet. filed), similarly seems to endanger long-established contract interpretation principles. In *Joppich*, the Houston Court of Appeals concluded that a recital of acknowledgment of consideration received, such as “In consideration of the sum of ten dollars, the receipt and sufficiency of which is hereby acknowledged and confessed,” operated as “no more than a statement of fact, which may be contradicted by parol evidence.” *Id.* at *3. But see *Herrmann v. Lindsey*, No. 04-02-00184-CV, 2003 WL 354464 (Tex. App.—San Antonio, Feb. 19, 2003) (unlike contract principles, grantor of deed has no right of rescission based upon a total or partial failure of consideration).

200. See, e.g., *First Nat’l Bank of Lake Park v. Gay*, 694 So. 2d 784 (Fla. Dist. Ct. App. 1997). In Florida’s *First Nat’l Bank*, plaintiff lessee sued defendant lessor for failing to use its “best efforts” to induce another tenant to terminate its lease early. *Id.* at 787. When

used without further definition or clarification other than the insertion of terms such as "reasonable" or "commercially reasonable" in an effort to avoid a construction of "best efforts" that would require an unlimited expenditure of funds or the incurrence of a severe loss to fulfill the duty.²⁰¹

Among the various states, the majority rule is to enforce "best efforts" clauses.²⁰² However, determining what "best efforts" entails varies greatly from court to court.²⁰³ Even the seminal *Bloor v. Falstaff Brewing*

submitting its jury charge, the plaintiff sought to define "best efforts" with a standard that the trial judge quickly rejected as too demanding. *Id.* (The judge commented that "the way [the jury instruction] reads, you would almost think the [lessor has] to take an UZI submachine gun and go down there and say 'end this lease[!]'"). *Id.* The Florida appellate court recognized that "[t]he definition of 'best efforts' may vary depending upon the factual circumstances surrounding the transaction and the intent of the parties in entering into the transaction." *Id.* at 788.

201. See, e.g., *In re Heard*, 6 B.R. 876 (Bankr. W.D. Ky. 1980); 407 East 61st Garage, Inc. v. Savoy Fifth Ave. Corp., 244 N.E.2d 37 (N.Y. 1968). Notwithstanding the common fear of the corporate attorney that "best efforts" requires the promisor to spend itself into bankruptcy, few cases have in fact found the standard to require such extreme actions, and most find the standard to be based on an obligation to act in good faith under the particular circumstances. See, e.g., *In re Chateaugay Corp.*, 198 B.R. 848, 854 (S.D.N.Y. 1996), *aff'd* 108 F.3d 1369 (2d Cir. 1997) (A party is entitled to give "reasonable consideration to its own interests" in determining an appropriate course of action to reach the desired result); *Triple-A Baseball Club Assocs. v. Northeastern Baseball, Inc.*, 832 F.2d 214, 227-28 (1st Cir. 1987) ("We have found no cases, and none have been cited, holding that "best efforts" means every conceivable effort.); *W. Geophysical Co. of Am. v. Bolt Assocs., Inc.*, 584 F.2d 1164 (2d Cir. 1978) (Parties may exercise discretion, within their good faith judgment, in devising a strategy for achieving their ultimate goal.); *Perma Research & Dev. Co. v. Singer Co.*, 308 F. Supp. 743 (S.D.N.Y. 1970); *Arnold Prods., Inc. v. Favorite Films, Corp.*, 176 F. Supp. 862 (S.D.N.Y. 1959), *aff'd* 298 F.2d 540 (2d Cir. 1962). However, more recent cases have leaned toward concluding that "best efforts" is a more precise and higher standard than "good faith," although how much higher varies from court to court, and "whether such obligation has been fulfilled will almost invariably . . . involve a question of fact." *Kroboth v. Brent*, 215 A.D.2d 813, 814 (N.Y. App. Div. 1995); see, e.g., *Nat'l Data Payment Sys., Inc. v. Meridian Bank*, 212 F.3d 849, 854 (3d Cir. 2000) ("The duty of best efforts 'has diligence as its essence' and is 'more exacting' than the usual contractual duty of good faith.") (citing E. Allan Farnsworth, *FARNSWORTH ON CONTRACTS* 383-84 (2d ed. 1998); *T.S.I. Holdings, Inc. v. Jenkins*, 924 P.2d 1239, 1250 (Kan. 1996) ("The two standards [of good faith and best efforts] are distinct and that of best efforts is the more exacting, though it presumably falls short of the standard required of a fiduciary . . ."); *Satellite Broad. Cable, Inc. v. Telefonica De Espana*, 807 F. Supp. 210, 217 (D.P.R. 1992) (effect of the particular "best efforts" clause at issue is to expand "beyond a mere good faith requirement"); *Kroboth*, 215 A.D.2d at 814 ("'Best efforts' requires more than 'good faith,' which is an implied covenant in all contracts . . . best efforts requires that plaintiffs pursue all reasonable methods . . .").

202. See James M. Van Vliet, Jr., "Best Efforts" Promises Under Illinois Law, 88 ILL. B.J. 698 (2000). The minority view tends to conclude that promises to use best efforts are illusory. See E. Allan Farnsworth, *On Trying to Keep One's Promises: The Duty of Best Efforts in Contract Law*, 46 U. PITT. L. REV. 1 (1984). An example of such a state is Illinois. In Illinois, a promise to use "best efforts," without more, is too vague to create a binding contractual obligation. See, e.g., *Krafco Corp. v. Kolbus*, 274 N.E.2d 153 (Ill. App. Ct. 1971). However, if the parties have defined what constitutes "best efforts," the "best efforts" promise is enforceable. See, e.g., *Heritage Remediation / Eng'g, Inc. v. Wendnagel*, No. 89C413, 1989 WL 153373 (N.D. Ill. Nov. 9, 1989).

203. See J.C. Bruno, "Best Efforts"—More or Less, 14 MICH. BUS. L.J. 1 (1991). Even the method in which courts seek to determine what "best efforts" means is varied. Courts have generally responded in one of two ways. The first is to imagine the parties united as a single person and to ask what efforts a reasonable person in that situation would exert on

Corp.,²⁰⁴ does little to add clarity to the uncertain issue of what “best efforts” means.²⁰⁵ Thus, when the Fifth Circuit Court of Appeals opted to hear *Herrmann Holdings, Ltd. v. Lucent Technologies, Inc.*,²⁰⁶ a case which involved a “best efforts” provision, it was an opportunity to shed light on the murky phrase.

On June 16, 2000, Lucent and the Herrmanns, the owners of Herrmann Technology, Inc. (“HTI”), signed a merger agreement in which Lucent acquired HTI for 6,770,200 shares of Lucent stock.²⁰⁷ But because the Herrmanns would be unable to sell their Lucent stock on the open market until Lucent filed a Form S-3 registration statement with the Securities and Exchange Commission (“SEC”) and the SEC subsequently declared it effective, a specific provision in the merger agreement was included to address this issue:

Lucent shall use its *reasonable best efforts*²⁰⁸ to prepare, file and cause to become effective, *as promptly as practicable* after Lucent shall have received all relevant information to be provided by [HTI] or [the Herrmanns] in connection with such filing, the Registration Statement covering the public resale of such shares of Lucent Common Stock to be issued in connection with the Merger . . . Agreement.²⁰⁹

Another provision in the merger agreement similarly obligated Lucent to:

use its *reasonable best efforts* to take or cause to be taken all actions, and to do, or cause to be done, all things necessary, proper or advisable under applicable Law to consummate and make effective in *the*

his own behalf. See Farnsworth, *supra* note 202, at 9. The second interpretation of what constitutes “best efforts” is to imagine a third person to be in the place of the party who has promised to act with “best efforts” and to ask what efforts a reasonable person in that situation would exert. See *id.*

204. *Bloor v. Falstaff Brewing Corp.*, 601 F.2d 609 (2d Cir. 1979). Falstaff bought most of the assets of Ballantine, a regional beer brewer, and explicitly agreed to “use its best efforts to promote and maintain a higher volume of sales” so that the owner of Ballantine could receive royalties. *Id.* at 610. Subsequently, another owner took control of Falstaff and began cutting costs. Sales of Ballantine greatly decreased and the royalties of Ballantine’s former owner decreased. *Id.* at 611-12. The Second Circuit affirmed the trial court’s finding that Falstaff had breached the “best efforts” provision. *Id.* at 616.

205. As Allan Farnsworth has noted, because the defendant in *Bloor* “fell so far short of the mark,” little precision was added to the definition of “best efforts.” Farnsworth, *supra* note 202, at 11.

206. *Herrmann Holdings Ltd. v. Lucent Techs., Inc.*, 302 F.3d 552 (5th Cir. 2002).

207. *Id.* at 556. Based on the closing price of \$60 that day, the Herrmanns’ newly acquired shares were worth approximately \$438 million. *Id.*

208. “Reasonable best efforts” was defined in the merger agreement to mean “prompt, substantial and persistent efforts as a prudent Person desirous of achieving a result would use in similar circumstances; provided that [the parties involved], as applicable, shall be required to expend only such resources as are commercially reasonable in the applicable circumstances.” *Id.* at 557. While there are no cases that directly analyze the difference between “best efforts” and “reasonable best efforts,” the phrases should not be interpreted interchangeably. See, e.g., *Stamicarbon, N.V. v. American Cynamid Co.*, 506 F.2d 532, 538 (2d Cir. 1974) (in the context of a “reasonable best efforts” clause, the Second Circuit concludes that the word “reasonably” must add some meaning to the concept of “best efforts”).

209. *Id.* at 556 (emphasis added).

most expeditious manner practicable, the transactions contemplated by [the merger] Agreement including . . . the making of all necessary registrations and filing and the taking of all reasonable steps as may be necessary to obtain an approval or waiver from, or to avoid an action or proceeding by any governmental or regulatory authority.²¹⁰

Eleven days after the HTI acquisition, Lucent's counsel asked the Herrmanns whether it was acceptable to delay the filing of the HTI S-3 for a few weeks because Lucent was acquiring another much larger telecommunications company, and Lucent wished to combine the two filings.²¹¹ The Herrmanns responded in the negative and instructed Lucent to proceed as originally planned.²¹² A few days later, Lucent sent the Herrmanns questionnaires seeking information for preparing the S-3 registration statement, and although the Herrmanns had already provided this information before closing, they resent the information to Lucent a few days later.²¹³ More telephone calls from the Herrmanns inquiring about the status of the S-3 followed.²¹⁴

On July 20, 2000, Lucent reported disappointing third quarter financials and lowered its fourth quarter estimates.²¹⁵ The next day, Lucent sent the Herrmanns a draft of the registration statement for their review.²¹⁶ Surprisingly, the draft showed that Lucent had combined the registration of shares from the HTI acquisition and the other latter acquisition.²¹⁷ Six weeks after the HTI acquisition, on July 28, 2000, Lucent filed the combined S-3 registration statement and on August 7, 2000, the SEC declared the S-3 effective.²¹⁸

The Herrmanns bought suit against Lucent in federal court for various claims, including breach of contract, specifically alleging that Lucent failed to use its reasonable best efforts to file and cause to become effective the registration statement as required by the merger agreement.²¹⁹ With Judge Fish of the Northern District of Texas presiding, the court began by stating that Texas law governed the case.²²⁰ However, because there existed no Texas Supreme Court precedent on the enforceability of best effort clauses in a breach of contract action, the court would instead defer to the Dallas Court of Appeals decision *CKB & Associates, Inc. v.*

210. *Id.* (emphasis added).

211. *Id.* at 557.

212. *Id.*

213. *Id.*

214. *Id.*

215. *Id.* The poor news caused Lucent's stock price to fall from \$64.50 to \$54.31. *Id.*

216. *Id.*

217. *Id.*

218. *Id.* That day, Lucent stock closed at \$42.06. *Id.*

219. *See Herrmann Holdings, Ltd. v. Lucent Techs., Inc.*, No. Civ. A. 301CV0625G, 2001 WL 1295496 (N.D. Tex. Oct. 5, 2001).

220. *Id.* at *3. Since the court's jurisdiction was based on diversity of citizenship, the court had a duty to apply Texas law. *See Erie R.R. Co. v. Tompkins*, 304 U.S. 64, 79-80 (1938).

Moore McCormack Petroleum, Inc.,²²¹ which held that “to be enforceable, a best efforts contract must set some kind of goal or guideline against which best efforts may be measured.”²²² If such guideline exists, then the “contracting party that performs within [such] guidelines fulfills the contract regardless of the quality of its efforts.”²²³

The district court analogized that in the instant case, the one and only goal established in the merger agreement was for Lucent to file and cause to become effective a registration statement covering the Herrmann’s shares.²²⁴ Because the parties never specified a particular date in which the task was to be completed, the district court concluded that Lucent met this goal by in fact filing the S-3 and causing it to become effective, and thus successfully “discharge[d] its obligations under the [agreement] regardless of the quality of its efforts.”²²⁵ The district court ended its analysis by stating that in considering whether a goal in a contract has been accomplished, the law in Texas does not have a court inquire into the “circumstance of the case or to comparable performances.”²²⁶ Because the only objective goal was successful registration, and Lucent satisfied that goal, the analysis of whether there is a breach of contract should end.²²⁷ Judge Fish subsequently granted Lucent’s motion to dismiss all of the Herrmanns’ claims and entered final judgment for Lucent.²²⁸ On appeal, however, the Fifth Circuit Court of Appeals, with Judge Stewart delivering the opinion, concluded that dismissing the Herrmann’s contract case would be premature and thus reversed the district court’s holding.²²⁹

The Fifth Circuit began its analysis by agreeing with the district court’s reliance on the *CKB* framework.²³⁰ However, it took issue with the district court’s narrow reading of the phrase “some kind of goal or guideline” that is required to enforce a best efforts clause under *CKB*.²³¹ The Fifth Circuit disagreed with the proposition that because there lacked a specific due date in the agreement, the language “as promptly as practicable” and “in the most expeditious manner practicable” would essentially have to be written out of the contract.²³² The district court’s conclusion

221. *CKB & Assocs., Inc. v. Moore McCormack Petroleum, Inc.*, 809 S.W.2d 577 (Tex. App.—Dallas 1991, writ denied).

222. *Id.* at 581-82. *Accord* *Maranatha Temple, Inc. v. Enter. Prods. Co.*, 893 S.W.2d 92, 103-04 (Tex. App.—Houston [1st Dist.] 1994, writ denied) (“[T]he words ‘good faith effort’ or ‘best effort’ are not talismanic; their presence in an agreement does not automatically mean that the provision which contains them is enforceable.”).

223. *Herrmann* (N.D. Tex.), 2001 WL 1295496, at *3 (citing *CKB*, 809 S.W.2d at 582).

224. *Id.* at *4.

225. *Id.*

226. *Id.*

227. *Id.*

228. *Id.*

229. *Herrmann* (5th Cir.), 302 F.3d at 561.

230. *Id.* at 559.

231. *Id.*

232. *Id.* The Fifth Circuit concluded that neither *CKB* nor any other Texas case supports the position that in a case where the best efforts clause relates to timeliness or the time that a task must be completed, the goal or guideline must be date specific. *See id.* at

would render the language of the agreement meaningless, which is contrary to the principle that courts should give significance to each clause in a contract.²³³

After citing to case law from other jurisdictions which analyzed similar language,²³⁴ the Fifth Circuit concluded that the true goal established by the best efforts provision was for Lucent to file and cause to become effective "as promptly as practical" and "in the most expeditious manner practicable" a registration statement covering the Herrmann's shares.²³⁵ Thus, because the Herrmanns alleged that Lucent had not timely filed the registration statement, there existed a valid breach of contract claim which the district court had prematurely dismissed.²³⁶

In upholding the Herrmann's claim, the Fifth Circuit in effect gave credence to the belief held by those who draft agreements that courts should always seek to interpret contracts as written. There is meaning and intent behind every word of an agreement. However, although the Fifth Circuit's decision validates the enforceability of "best efforts" clauses, it is nonetheless important for contracting parties who desire to include a "best efforts" clause to continue to define as precisely as possible what level of performance they intend, such as using qualifiers like "as promptly as practical" and "in the most expeditious manner practicable" as the *Herrmann Holdings* parties did. Only by further defining what constitutes "best efforts" can parties adequately assure that their intention will be understood by each other, and more importantly, enforced by the courts.

560. As the Fifth Circuit states, "[r]equiring contracting parties to fix a date certain in order to set a temporal guideline in which to complete a certain task demands more definiteness than Texas law requires." *Id.*

233. *See id.* at 559-60 (citing *Balandran v. Safeco Ins. Co. of Am.*, 972 S.W.2d 738, 741 (Tex. 1998) ("Our primary goal . . . is to give effect to the written expression of the parties' intent. We must read all parts of the contract together, striving to give meaning to every sentence, clause, and work to avoid rendering any portion inoperative.")).

234. Among the cases that the Fifth Circuit cited was *Thomas De La Rue AG v. United States Banknote Corp.*, 979 F. Supp. 968 (S.D.N.Y. 1997). In *Thomas*, the United States Banknote Corp. ("Banknote") acquired a company, transferring Banknote stock to Thomas De La Rue AG ("TDLR") as part of consideration for the sale, and agreed that, upon TDLR's written request that Banknote register the shares, it "would prepare and file the registration statement 'as expeditiously as possible and would thereafter use its 'best efforts' to cause the registration statement to become effective.'" *Id.* at 970. Banknote did not file the registration statement until nearly six months after the TDLR's written request for registration. *Id.* The TDLR sued Banknote for breach of contract, and upon TDLR's motion for partial summary judgment, the court held that the registration provision at issue was not ambiguous. *Id.* at 972. Instead, it imposed an obligation on Banknote "to act as expeditiously as reasonably possible under the circumstances." *Id.* Since there were genuine issues of material fact which existed as to whether Banknote in fact did act as the contract required, it was for a jury to decide whether the delay was a breach of Banknote's obligations under the contract. *Id.* at 972-73.

235. *See Herrmann* (5th Cir.), 302 F.3d at 561.

236. *See id.*

2. *Interpretation of Employee Stock Option Agreements: Monsanto Co. v. Boustany*

During this Survey period, the Texas Supreme Court reversed an appellate court decision which was discussed in the Corporations Survey three years ago.²³⁷ In *Monsanto Co. v. Boustany*,²³⁸ employees of Fisher Controls International, Inc., a wholly-owned subsidiary of Monsanto Company, were granted options to purchase Monsanto stock as part of an incentive and compensation plan.²³⁹ Pursuant to an agreement governed by Delaware law, such options would expire ten years from the date that they were granted or upon termination of employment, whichever occurred first.²⁴⁰ Subsequently, another company fully acquired the Fisher subsidiary from Monsanto; however, employees of Fisher continued their employment and retained their positions.²⁴¹

Four years after the sale of Fisher and within the ten-year vesting window, certain Fisher employees sought to exercise their Monsanto stock options, some priced as low as \$44, as Monsanto stock had dramatically risen to almost \$160 per share.²⁴² Not surprisingly, Monsanto refused to honor the options,²⁴³ and in response, 110 Fisher employees sought judicial remedy.²⁴⁴ The plaintiffs sued their employer's former parent for varied claims, including breach of contract, claiming that the refusal of Monsanto to honor their stock options was wrongful.²⁴⁵ The case hinged on one issue: whether the sale of Fisher to another company constituted a "termination of employment," which in turn would determine whether Monsanto had rightfully refused the plaintiffs' option exercise.

As highlighted in the year 2000 Corporations Survey,²⁴⁶ the Houston Court of Appeals used plain-meaning construction to declare that the sale of Fisher was simply a change of control and ownership of a subsidiary, and not at all a termination of the plaintiffs' employment when they

237. *Id.* West & Fairman, *supra* note 4, at 783 (discussing the state appellate decision).

238. *See Monsanto Co. v. Boustany*, 73 S.W.3d 225 (Tex. 2002).

239. *Monsanto*, 73 S.W.3d at 227.

240. *Id.*

241. *Id.*

242. *Id.* at 228. The options ranged in price from \$44.312 per share to \$67.125 per share. *Id.* During the year after Monsanto sold Fisher, Monsanto's stock had only reached a high of \$66.25. Thereafter, up until the time that the employees sought to exercise their options, Monsanto stock continued to increase in value. *Id.*

243. *Id.* Immediately after the sale of Fisher, Monsanto's compensation committee had concluded that a provision in the option certificates required options to be exercised within three months after termination of employment by Monsanto. *Id.* at 227-28. However, the market price of Monsanto stock was lower than the price that some of the stock options could be exercised, which meant that the employees could not profitably exercise those options within the three-month window. *Id.* at 228. Thus, the compensation committee decided to extend the time for Fisher employees to exercise those options an additional nine months. *Id.* Consequently, the employees were given one year after Monsanto sold Fisher to exercise their stock options. *Id.* Monsanto's stock price rose above the various option prices within that one-year window, and thus Fisher employees did have the opportunity to profitably exercise their options. *Id.*

244. *Id.*

245. *Id.*

246. *See West & Fairman, supra* note 4, at 783.

were “still employed by Fisher, in the same management positions performing the same job tasks.”²⁴⁷ Thus, when faced with a situation seemingly unaccounted for in the stock option agreement, the appeals court reaffirmed the often-repeated principle that “[a] court may not, in the guise of construing a contract, in effect rewrite it to supply an omission in its provisions” and found for the plaintiffs.²⁴⁸ Confronted with paying substantial damages, Monsanto appealed and the Texas Supreme Court, with Justice Owen delivering the opinion, reversed the appeals court decision.²⁴⁹

Contrary to the court of appeals decision, the Texas Supreme Court came to the conclusion that the sale of the Fisher subsidiary was in fact a “termination of employment.” The supreme court first stated familiar contract principles: “An agreement should be read as a whole in discerning the parties’ intent and if possible, interpreted to reconcile all of the provisions of the document.”²⁵⁰ “If no ambiguity is present, the Court must give effect to the clear language.”²⁵¹ The supreme court then began its analysis by tracing through the governing stock option agreement to determine the meaning of “termination of employment.” The agreement did not provide much guidance as it defined “termination of employment” as “the discontinuance of employment of [any employee of Monsanto or a Subsidiary to whom a stock option has been granted] for any reason other than a Transfer.”²⁵² However, the supreme court noted that “Subsidiary” had two separate definitions depending on which type of stock option an employee held: one definition, governing those options which the plaintiffs did not possess, determined whether a company was a Subsidiary at the time the option was granted; the other definition, governing those options which the plaintiffs did possess, had no such qualifier, meaning that a company could cease being a Subsidiary at anytime during the term of the agreement.²⁵³ This distinction, the supreme court

247. *Boustany v. Monsanto Co.*, 6 S.W.3d 596, 600 (Tex. App.—Houston [1st Dist.] 1999, pet. granted).

248. *Id.* at 601.

249. *See Monsanto* (Tex.), 73 S.W.3d at 228-29.

250. *Id.* at 229 (citing *Kaiser Alum. Corp. v. Matheson*, 681 A.2d 392, 395 (Del. 1996)).

251. *Id.* (citing *Johnston v. Tally Ho, Inc.*, 303 A.2d 677, 679 (Del. Super. Ct. 1973)).

252. *Id.* at 230. The stock option agreement itself defined “termination of employment” to mean “the discontinuance of employment of a Participant for any reason other than a Transfer.” *Id.* Participant was defined as “an Eligible Participant to whom a Stock Option has been granted.” *Id.* “Eligible Participants” were defined as “any employee of the Company, a Subsidiary or any Associated Company.” *Id.* Transfer was defined as “a change of employment of a Participant within the group consisting of the Company and its Subsidiaries.” *Id.* at 231.

253. *Id.* at 230-31. Subsidiary was defined in the stock option agreement as follows:

for the purposes of an Incentive Stock Option, any corporation (other than [Monsanto] in an unbroken chain of corporations beginning with [Monsanto] if, at the time of the granting of the Option, each of the corporations other than the last corporation in the unbroken chain owns stock possessing 50% or more of the total combined voting power of all classes of stock in one of the other corporations in such chain; and (ii) for the purposes of Non-Qualified Stock Option . . . , any corporation (or partnership, joint venture, or other enterprise) of which [Monsanto] owns or controls, directly or indi-

concluded, meant that the moment Fisher ceased being controlled by Monsanto, the plaintiffs also ceased being employees of a "Subsidiary," notwithstanding their continuance as employees of Fisher.²⁵⁴ In effect, a "termination of employment" had occurred which allowed Monsanto to refuse to honor the plaintiffs' stock options.²⁵⁵ The supreme court subsequently reversed the appeals court decision and found for Monsanto.²⁵⁶

As a practical matter, one of the main reasons companies provide stock options is to provide an incentive to employees so that they may seek to contribute to company value and growth. The desire by Monsanto for such stock options to expire for Fisher employees after a change of ownership of Fisher is obvious. However, this intent was never clearly established in the stock option agreement, and because of that litigation ensued.²⁵⁷ Although a favorable result for Monsanto was eventually achieved, it is nevertheless important that corporate practitioners remember to articulate provisions with specificity, as the potential risk that the contracting parties' intent will be wrongly interpreted by either judge or jury can be great.²⁵⁸

rectly, 50% of more of the outstanding shares of stock normally entitled to vote for the election of directors (or comparable equity participating and voting power).

Id. at 230 n.2.

254. *Id.* at 231.

255. *Id.* at 232.

256. *Id.* at 233.

257. *See also* Pers. Sec. & Safety Sys., Inc. v. Motorola, Inc., 297 F.3d 388 (5th Cir. 2002). Here, an arbitration provision was included in an ancillary agreement, but not the main stock purchase agreement. *Id.* at 391. The plaintiff argued that a claim under the stock purchase agreement was not subject to the arbitration provision because the intent of the parties was for the arbitration provision to only apply to the ancillary agreement, and not to govern the parties' entire relationship. *Id.* at 393-94. The Fifth Circuit Court of Appeals disagreed and concluded that "the individual agreements were integral and inter-related parts of the one deal." *Id.* at 393.

258. This Survey period also brought a number of opportunities for the Texas courts to remind corporate practitioners of both the express negligence and conspicuous indemnity doctrines, which are the standards used by Texas courts to determine the validity of a contractual clause that seeks to disclaim or indemnify a party from its own negligence. Under the express negligence rule, a party who wishes to contractually shift risk from itself for the consequences of its future negligence must specifically express that intent within the four corners of an agreement. *See Ethyl Corp. v. Daniel Constr. Co.*, 725 S.W.2d 705 (Tex. 1987). Moreover, the conspicuous indemnity doctrine states that in order for an indemnity against one's own negligence to be effective, the indemnity agreement must provide conspicuous notice of the existence of that provision to draw the attention of the party providing the indemnity. *See Dresser Indus., Inc. v. Page Petroleum, Inc.*, 853 S.W.2d 505 (Tex. 1993). This Survey period, the courts continued to implement the express negligence rule in the context of indemnification provisions. *See, e.g., Missouri Pac. R.R. Co. v. Lely Dev. Corp.*, 86 S.W.3d 787 (Tex. App.—Austin 2002, pet. dismissed) (in reversing the trial court decision, the court concluded appellee had actual knowledge of the indemnity provision in a construction contract); *Banner Sign & Barricade, Inc. v. Price Constr., Inc.* 94 S.W.3d 692 (Tex. App.—San Antonio 2002, pet. denied) (concluding that the inclusion of the phrase "regardless of cause or of the sole, joint, comparative, concurrent negligence or gross negligence" in a corporate officer indemnification provision satisfies the express negligence rule); *Reyes v. Storage & Processors, Inc.*, 86 S.W.3d 344 (Tex. App.—Texarkana 2002, pet. filed) (concluding that a release and indemnity provision in an employee benefit plan was subject to the express negligence rule); *DDD Energy, Inc. v. Veritas DGC Land, Inc.*, 60 S.W.3d 880 (Tex. App.—Houston [14th Dist.] 2001, no pet.) (concluding that the

provision at issue failed the express negligence test, and thus there was no need to reach the conspicuous notice requirement). Another interesting case decided this Survey period involving indemnification was *Drilltec Technologies, Inc. v. Remp*, 64 S.W.3d 212 (Tex. App.—Houston [14th Dist.] 2001, no pet.), in which the Houston Court of Appeals, because of ambiguous drafting, “attempt[ed] to trace a right of indemnity through a corporate web that would make a spider dizzy.” *Id.* at 213. The court ultimately concluded that the indemnity had been transferred to the only party who actually needed it—the buyer who bargained for indemnity as part of the purchase price. *Id.* at 216.