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De Facto Merger in Texas: Reports of Its Death Have Been Greatly Exaggerated

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Introduction

If an agreement between combining corporations has the essential characteristics of a merger, the failure of the merging parties to follow statutory procedures should not deprive third party creditors of re-

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lief.[1] To protect such third parties, courts have created the doctrine of *de facto* merger.[2] "*[D]e facto* merger occurs where one corporation is absorbed by another, but without compliance with the statutory requirements for a merger."[3] A similar result is obtained in the related concept of *consolidation.* In a *merger*, one of the combining corporations absorbs the other and continues to exist after the merger. However, in a *consolidation*, all of the combining corporations are dissolved and lose their identity in a completely new corporate entity. The new corporation then takes over the properties, powers, privileges, and liabilities of the constituent corporations.[4]

The significance of determining whether a merger or a *de facto* merger occurs is that in either case the successor corporation becomes liable for the debts of the predecessor corporation(s):

> When a merger takes effect: . . . all liabilities and obligations of each domestic and foreign corporation and other entity that is a party to the merger shall be allocated to one or more of the surviving or new domestic or foreign corporations and other entities in the manner set forth in the plan of merger . . . .[5]

Similar language may be found in the laws of other states which have adopted the Model Business Corporations Act.[6]

In 1979, the Texas Legislature added article 5.10(B) to the Texas Business Corporations Act.[7] The Bar Committee Comments accompanying the statute[8] attribute an intent to the statute that this comment will demonstrate overstated the legislative intent of the House and Senate.[9] As a result, courts and commentators have interpreted the amendment as eliminating the *de facto* merger doctrine in Texas.[10]

1. Knapp v. North Am. Rockwell Corp., 506 F.2d 361, 367 (3d Cir. 1974), *cert. denied*, 421 U.S. 965 (1975).

2. *See, e.g.*, Arnold Graphics Indus. v. Independent Agent Ctr., Inc., 775 F.2d 38 (2d Cir. 1985).

3. *Id.* at 42 (emphasis added).

4. Freeman v. Hiznay, 36 A.2d 509, 511 (Pa. 1944).

5. TEX. BUS. CORP. ACT ANN. art. 5.06(A)(3) (West Supp. 1996).

6. "When a merger takes effect: . . . the surviving corporation has all liabilities of each corporation party to the merger . . . ." MODEL BUSINESS CORP. ACT § 11.06(a)(3) (1991).

7. TEX. BUS. CORP. ACT ANN. art. 5.10 (West 1980).

8. *Id.* art. 5.10 cmt. of the Bar Committee - 1957 to 1979. "The 1979 amendment added Article 5.10(B), the purpose of which is to preclude the application of *de facto* merger in any sale, lease, exchange or other disposition of all or substantially all the property and assets of a corporation requiring authorization under Article 5.10(A)." *Id.*

9. *See* discussion *infra* pp. 602-15.

10. *See, e.g.*, Aguirre v. Armstrong World Indus., 901 F.2d 1256, 1258 (5th Cir. 1990); Suarez v. Sherman Gin Co., 697 S.W.2d 17, 20 (Tex. App.—Dallas 1985, writ ref'd n.r.e.); Mudgett v. Paxson Mach. Co., 709 S.W.2d 755, 758 (Tex. App.—Corpus Christi 1986, writ ref'd n.r.e.); Castilla v. Trinity Indus., 626 S.W.2d 798, 802 (Tex. App.—San Antonio 1981, writ dism'd).

Thus, courts have mistakenly interpreted the statute more broadly than the Texas Legislature intended.

This comment examines three issues of Texas *de facto* merger law. First, whether the Texas Legislature's 1979 amendment to Article 5.10 of the Texas Business Corporations Act was intended to eliminate the *de facto* merger doctrine, regardless of how closely a transaction resembles a merger. Second, whether the 1987 and 1991 amendments to Article 5.10 are additional evidence of a legislative intent to eliminate the *de facto* merger doctrine. And, if so, whether it was sound public policy to completely eliminate the *de facto* merger doctrine.

I. Background of the *De Facto* Merger Doctrine in Texas

Generally, the "mere sale" of a corporation's assets does not make the purchaser liable for pre-existing liabilities of the seller that are not expressly assumed.[11] There are, however, certain exceptions to this rule:

> Liability for obligations of a selling corporation may be imposed on the purchasing corporation when (1) the purchaser expressly or impliedly agrees to assume such obligations; (2) the transaction amounts to a consolidation or merger of the selling corporation with or into the purchasing corporation; (3) the purchasing corporation is merely a continuation of the selling corporation; or (4) the transaction is entered into fraudulently to escape liability for such obligations.[12]

In order to deem a particular corporate transaction a *de facto* merger courts look beyond the agreements of the corporate parties to determine if the characteristics of a merger exist.[13] These characteristics are as follows:

> (1) There is a continuation of the enterprise of the seller corporation, so that there is a continuity of management, personnel, physical location, assets, and general business operations.
> (2) There is a continuity of shareholders which results from the purchasing corporation for the acquired assets with shares of its own stock, this stock ultimately coming to be held by the shareholders of the seller corporation so that they become a constituent part of the purchasing corporation.
> (3) The seller corporation ceases its ordinary business operations, liquidates, and dissolves as soon as legally and practically possible.
> (4) The purchasing corporation assumes those liabilities and obligations of the seller ordinarily necessary for the uninterrupted continuation of normal business operations of the seller corporation.[14]

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11. *Knapp*, 506 F.2d at 363.
12. *Id.* at 363-64.
13. *See, e.g.*, Farris v. Glen Alden Corp., 143 A.2d 25, 28 (Pa. 1958).
14. Western Resources Life Ins. Co. v. Gerhardt, 553 S.W.2d 783, 786 (Tex. Civ. App.—Austin 1977, writ ref'd n.r.e.); *see also* McKee v. Harris-Seybold Co., 264 A.2d 98, 103 (N.J. Super. Ct. Law Div. 1970), *aff'd*, 288 A.2d 585 (N.J. Super. Ct. App. Div.

In 1977, *Western Resources Life Insurance Co. v. Gerhardt*[15] presented the most significant test to date of the *de facto* merger doctrine in Texas.

A. Western Resources Life Insurance Co. v. Gerhardt

In *Western Resources Life Insurance Co. v. Gerhardt*, the Austin Court of Appeals applied the *de facto* merger doctrine in an insurance fraud case.[16] The Austin court held that under the *de facto* merger doctrine, Western Resources Life Insurance Company ("W. R. Life") was the successor corporation to American Business and Commercial Life Insurance Company ("ABC"). Thus, W. R. Life assumed the tort liabilities of ABC.[17] These liabilities included the judgment Gerhardt obtained after proving that agents of ABC defrauded him prior to the alleged merger of the two corporations.[18]

Predictably, W. R. Life argued that it had merely purchased the assets of ABC, but did not agree to accept ABC's contingent liabilities, and therefore should not be held liable for the conduct of ABC's agents prior to becoming agents of W. R. Life.[19] To support its argument, W. R. Life relied on the purchase agreement between W. R. Life and ABC. The agreement provided in part: 1) W. R. Life would purchase all of ABC's assets with W. R. Life stock plus $25,000 in cash to cover transaction costs; 2) ABC's management and agency force would affiliate with W. R. Life; 3) W. R. Life's Board of Directors would be increased from nine members to fifteen members, three of the directors were to be ABC's former directors and six new directors were to be designated by ABC; 4) ABC would dissolve after distributing the W. R. Life shares to ABC's shareholders; and 5) an express provision that W. R. Life would not assume ABC's contingent liabilities.[20]

In deciding that a *de facto* merger had occurred, the court looked beyond the purchase agreement between the parties and applied the four part *de facto* merger test set forth in *Shannon v. Samuel Langston Co.*[21] The court acknowledged the general rule that "[w]hen one corporation transfers or sells its assets to another corporation, the purchaser is not usually liable for the debts and liabilities of the

1972); Shannon v. Samuel Langston Co., 379 F. Supp. 797, 800 (W.D. Mich. 1974); Knapp v. North Am. Rockwell Corp., 506 F.2d 361, 363-64 (3d Cir. 1974), *cert. denied*, 421 U.S. 965 (1975); Menacho v. Adamson United Co., 420 F. Supp. 128, 132 (D.N.J. 1976).

15. 553 S.W.2d at 783.
16. *Id.* at 787.
17. *Id.*
18. *Id.*
19. *Id.* at 785.
20. *Id.*
21. *See supra* note 14 and accompanying text.

transferor."[22] However, the court examined the transaction and determined that each element of a *de facto* merger was present.[23] Specifically, the court found that (1) W. R Life continued the enterprise of ABC by retaining ABC's management, personnel, physical location, assets, and general business operations; (2) ABC's shareholders merely exchanged their ABC shares for W. R. Life shares, thus maintaining a continuity of shareholders; (3) ABC ceased its ordinary independent business operations, liquidated, and dissolved; and (4) W. R. Life assumed the liabilities and obligations of ABC that were necessary for the uninterrupted continuation of ABC's normal business operations.[24] Based upon these findings, the Austin Court of Appeals held W. R. Life liable for the debts of ABC as if W. R. Life had been the successor corporation in a statutory merger.[25]

B. *Legislative Response to* Gerhardt

In 1979, two years after *Gerhardt*, the Texas Legislature amended the Texas Business Corporations Act adding section B to article 5.10.[26] The Bar Committee Comments following the statute note that

22. *Gerhardt*, 553 S.W.2d at 786.
23. *Id.*
24. *Id.*; *see also* Shannon v. Samuel Langston Co., 379 F. Supp. 797 (W.D. Mich. 1974).
25. *Gerhardt*, 553 S.W.2d at 786-87.
26. Section 5.10(B) reads:

> B. A disposition of all, or substantially all, of the property and assets of a corporation requiring the special authorization of the shareholders of the corporation under Section A of this article:
> (1) is not considered to be a merger or consolidation pursuant to this Act or otherwise; and
> (2) Except as otherwise expressly provided by another statute, does not make the acquiring corporation responsible or liable for any liability or obligation of the selling corporation that the acquiring corporation did not expressly assume.

TEX. BUS. CORP. ACT ANN. art. 5.10(B) (West 1980).
The Comment also states in relevant part:

> The 1979 amendment added Article 5.10.B., the purpose of which is to preclude the application of the doctrine of *de facto* merger in any sale, lease, exchange or other disposition of all or substantially all of the property and assets of a corporation requiring authorization under Article 5.10.A. Under the *de facto* merger doctrine, as announced in Western Resources Life Insurance Co. v. Gerhardt, 553 S.W.2d 783 (Tex. Civ. App.—Austin 1977, writ ref'd [sic] n.r.e.), an acquiring corporation can be held responsible for all liabilities of a selling corporation notwithstanding the absence of a contractual agreement to assume such liabilities or even if such assumption is contractually negated. The new statutory provision provides that the acquiring corporation in a purchase of assets transaction does not assume or otherwise become liable for liabilities of the corporation whose assets are purchased, unless the acquiring corporation agrees contractually to assume or become liable for such liabilities. However, by expressly excepting from the operation of section B the effect of "any other statute of this State," the statutory liabilities of an acquiring corporation under the bulk sales or fraudulent conveyances laws or similar statutes are left intact.

"the purpose [of Article 5.10(B)] is to preclude the application of the doctrine of *de facto* merger in any sale, lease, exchange or other disposition of all or substantially all the property and assets of a corporation requiring authorization under Article 5.10.A."[27] These official comments specifically refer to application of the *de facto* merger in *Gerhardt*.[28]

Texas courts have subsequently interpreted Article 5.10(B) as a negative legislative response to *Gerhardt*.[29] Additionally, authors writing on successor liability have parroted the language of these official comments, stating broadly that "[t]he purpose of the 1979 amendment was to preclude the application of the doctrine of *de facto* merger in any sale, lease, exchange, or other disposition of all or substantially all of the assets of a corporation."[30] Since then, these Bar Committee Comments have effectively become the law and *de facto* merger has been widely disregarded.[31]

II. Analysis of Texas Article 5.10(B)

A. *Approaches to Statutory Construction*

To determine the legislative intent of Article 5.10(B), it is first necessary to review the methods of statutory construction. Legislative intent is generally determined by utilizing three principle approaches: 1) the plain meaning, or textual, approach; 2) the evolutive, or context approach; and 3) the historical, legislative intent, or legal process approach.[32] It should be kept in mind that statutory interpretation in-

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Tex. Bus. Corp. Act Ann. art. 5.10 cmt. of the Bar Committee-1957 to 1979 (West 1980).

27. *Id.* art. 5.10 cmt. of the Bar Committee-1957 to 1979 (West 1980).

28. *Id.*

29. *See, e.g.*, Aguirre v. Armstrong World Indus., 901 F.2d 1256, 1258 (5th Cir. 1990); Suarez v. Sherman Gin Co., 697 S.W.2d 17, 20 (Tex. App.—Dallas 1985, writ ref'd n.r.e.); Mudgett v. Paxson Mach. Co., 709 S.W.2d 755, 758 (Tex. App.—Corpus Christi 1986, writ ref'd n.r.e.); Castilla v. Trinity Indus., 626 S.W.2d 798, 802 (Tex. App.—San Antonio 1981, writ dism'd).

30. James Ryan & Robert Beasley, *Asset Acquisitions: Caveat Emptor*, 53 Tex. B.J. 1222, 1222 (1990).

31. *Id.*

32. *See* William N. Eskridge, Jr., *Dynamic Statutory Interpretation*, 135 U. Pa. L. Rev. 1479, 1483 (1987); Edward J. Imwinkelried, *Using a Contextual Construction to Resolve the Dispute Over the Meaning of the Term "Plan" in Federal Rule of Evidence 404(B)*, 43 Kan. L. Rev. 1005, 1034-36 (1995); David J. Jesulaitis, *Lien Stripping After Nobelman v. American Savings Bank: What is "Additional Collateral?,"* 32 Hous. L. Rev. 201, 210-11 (1995). Each of these authors uses slightly different nomenclature to describe the three traditional approaches to statutory construction. Professor Eskridge argues for a fourth methodology which he calls *dynamic statutory* interpretation. *Dynamic statutory* interpretation is a broad based context approach that considers not only the surrounding text and related sections of the statute itself, but also the changes in the entire socio-economic-legal environment in which the statute is applied in the instant case compared with the socio-economic-legal environment that existed at the time the statute was passed.

volves the present day interpreter's understanding and reconciliation of the three different perspectives, not one of which necessarily controls.[33] Applying these approaches will shed new light on the legislative intent of 5.10(B).

1. Plain Meaning

Rules of statutory interpretation require that statutes enacted by the legislative majority be given effect and that individuals be given notice of the rules governing their behavior.[34] This notice requirement suggests two things. First, that legislative intent is irrelevant and that citizens are entitled to act in accordance with the plain meaning of a statute regardless of what the legislators intended. Second, that the statute itself states the intent of the law without requiring an individual to second guess legislative intent. This plain meaning, or textual approach, is based upon the reasoning that words should, not surprisingly, be interpreted according to their plain meaning.[35] Therefore, the language of a statute should provide the best, and some argue only, evidence of legislative intent.[36]

Statutory text certainly serves to limit the range of interpretive options available.[37] When statutory text clearly answers the interpretive question it should be the most important consideration.[38] If a statute can be read without ambiguity in a plain language jurisdiction, courts should look no further than the plain meaning of the words.[39] However, exceptions to this exist "because an apparently clear text can be rendered ambiguous by a demonstration of contrary legislative expectations or highly unreasonable consequences."[40] Thus, when plain language fails to clearly answer the question, or when some other evidence suggests an alternative interpretation, courts should look to context and legislative process for additional evidence of legislative intent.

2. Context

The context approach considers the text in question as part of a whole statutory scheme.[41] This approach is often used when two provisions of a statute are in conflict. In these instances, the general rule is to interpret each provision in order to avoid conflict.[42] Professor Eskridge further urges an interpreter to consider not only the sur-

33. Eskridge, *supra* note 32, at 1483.
34. *Id.*
35. Jesulaitus, *supra* note 32, at 211.
36. *Id.*
37. Eskridge, *supra* note 32, at 1483.
38. *Id.*
39. Jesulaitus, *supra* note 32, at 211.
40. Eskridge, *supra* note 32, at 1483.
41. Jesulaitus, *supra* note 32, at 211.
42. *Id.* at 211-12.

rounding text, other parts of the statute and related statutes, but also the evolution of the societal and legal environment over time to see if the meaning of the statute has materially changed.[43] Professor Eskridge considers the context approach, which he calls the evolutive approach, to be the most important approach when the statutory text is not clear and original legislative expectations have been overtaken by subsequent changes in society and law.[44]

Moreover, Professor Imwinkelreid reminds us that federal courts have resisted efforts to read statutory language in isolation, torn from context, and that ignoring context is a formula for disaster.[45] Imwinkelreid urges that the corpus of law is to be a "seamless web," and "courts must ensure the coherence of the related legal norms, both adjectival and substantive."[46]

3. Historical or Legislative Process

Scholars and judges agree that the historical perspective, also known as the legal process or legislative intent approach, is another important interpretive consideration.[47] There is general agreement that "given the traditional assumptions that the legislature is the supreme lawmaking body in a democracy, the historical expectations of the enacting legislature are entitled to deference."[48] However, there is little agreement on the weight to be given to the various extratextual materials that may shed light on legislative intent. Usually, courts use the legislative intent approach when the statute is ambiguous or when the plain meaning approach would lead to absurd results.[49]

Texas rules of statutory construction require courts to go beyond the plain language of the statute and ascertain legislative intent.[50] Moreover, once determined, legislative intent must be enforced by courts even though the intent may not be entirely consistent with the strict letter of the statute.[51]

Before evaluating the legislative intent of 5.10(B), courts should take note of Professor Imwinkelreid's warning that the past decade has witnessed a fundamental change in the approach to statutory in-

43. Eskridge, *supra* note 32, at 1483.
44. *Id.*
45. Imwinkelried, *supra* note 32, at 1035.
46. *Id.* at 1036.
47. *See, e.g.*, Jesulaitus, *supra* note 32, at 211-12; Eskridge, *supra* note 32, at 1483; Imwinkelried, *supra* note 32, at 1483; Dillehey v. State, 815 S.W.2d 623 (Tex. Crim. App. 1991); Patterson v. State, 769 S.W.2d 938 (Tex. Crim. App. 1989).
48. Eskridge, *supra* note 32, at 1483.
49. Jesulaitus, *supra* note 32, at 212.
50. *Dillehey*, 815 S.W.2d at 625; *Patterson*, 769 S.W.2d at 940 ("most common [rule of statutory construction] . . . is for the judiciary to attempt to effectuate the intent of the Legislature").
51. *Dillehey*, 815 S.W.2d at 625.

terpretation, particularly in federal court. Until recently, the dominant tradition has been the legal process approach.[52] However, looking at legislative intent may prove problematic if legislative history materials are allowed to trump the plain meaning of a text.[53]

The legislative intent approach has been criticized recognizing that legislation is a product of compromise shaped by expediency.[54] Generally, legislation is passed after a relatively small number of legislators determine the wisdom and language of a particular statute through a series of committee and subcommittee meetings. However, the whole legislative body has only outcomes [plain language] upon which they must cast their all or nothing vote.[55]

At least one commentator has observed that, while there may be a committee report, the vast majority of legislators casting votes approving a statute have no idea of a committee report's contents.[56] While that observation may not always hold true, it is fair to say the majority of legislators are not always familiar with the committee debates and compromises shaping the final language of a particular bill. Additionally, reports may have been drafted largely by special interest groups who are seeking to influence courts construing the statute.[57] Moreover, the particular phrasing of a report could add to, change, or shade the meaning of a particular statute in such a way that it could not have otherwise gained victory on the legislative floor.

Keeping these thoughts in mind, legislation should be viewed as a carefully negotiated contract between competing special interest groups. Therefore, legislation simply memorializes the end result of a negotiation process. Thus, if extra-textual materials are later interpreted liberally by courts or commentators, legislators who carefully consider the final wording of a particular statute, and base their votes

52. Imwinkelried, *supra* note 32, at 1034.
53. *Id.*
54. *Id.*
55. *Id.*
56. *Id.*
57. Imwinkelried, *supra* note 32, at 1034-35. This is precisely the circumstance behind the enactment of article 5.10(B) and its subsequent amendments. The original 5.10(B) was drafted by the Committee on Revision of Corporation Law of the Banking and Business Law Section of the State Bar of Texas. The 1987 amendment was drafted by the Texas Business Corporation Section of the State Bar. Finally, the 1991 amendment was drafted by the Texas Business Law Foundation, a group composed of corporations, attorneys and professors. In each of these years, the Texas Legislature passed these bills on recommendations of expert witnesses from the Bar. In at least one meeting, a lay committee member frankly admitted that the legislation was too technical for him to understand and that he was relying entirely on the expert's recommendations. *See An Act Relating to Disposition of Corporate Assets, Derivative Suits Against a Corporate Merger: Hearings on Tex. S.B. 142 Before the Senate Committee on Jurisprudence*, 66th Leg., R.S. Tape (Feb. 6, 1979) (transcript on file with *Texas Wesleyan Law Review*); *An Act Relating to the Authority and Operation of Certain Business Organizations Which Provide for Limited Liability, Hearings on Tex. H.B. 278 Before the House Business and Commerce Comm.*, 72nd Leg., R.S. Tape (Mar. 11, 1991) (tape on file with *Texas Wesleyan Law Review*).

on its plain language, may find they voted for a law that they strongly opposed. Interpreting legislative intent should, therefore, be a conservative undertaking that seeks to clarify the plain language, without contradicting it, or expanding it. This raises the question as to why the plain language of Article 5.10(B) has become secondary to its Bar Committee Comments.

B. Evidence of the Legislative Intent of Article 5.10(B)

The legislative intent of Article 5.10(B), and its amendments, were ascertained from a comprehensive review of the available extra-textual material showing the context and legislative process leading to passage of the statute.[58]

Article 5.10(B) began in the House as H.B. 387 with a companion bill, S.B. 142.[59] The Senate and House Bills were not materially different with respect to 5.10(B). Senator Ogg first introduced S.B. 142 in January 1979, at which time it was referred to the Senate Committee on Jurisprudence. The Committee on Jurisprudence then referred the bill to the Subcommittee on Civil Matters. The text of the original bill provided no additional evidence of legislative intent since there were no material differences between the original text of the bill and the final text of the statute. In addition to appending Section B to article 5.10, S.B. 142 amended other parts of the Texas Business Corporations Act as well. However, these amendments were not related to the *de facto* merger doctrine and are beyond the scope of this article.

The Subcommittee on Civil Matters heard S.B. 142 on January 30, 1979, when Senator Ogg again introduced the bill.[60] Senator Ogg's

58. The material reviewed included: 1) the text of House Bill H.B. 387 and companion S.B. 142 of the 66th Legislature; 2) the transcript of the Senate Hearing held April 23, 1979 at which the Senate passed S.B. 142; 3) the transcript of the Senate Jurisprudence Committee Hearing on S.B. 142, February 6, 1979; 4) the transcript of the House Business and Commerce Committee Hearing, February 5, 1979; 5) Transcript of the House Business and Commerce Committee Hearing, February 26, 1979; 6) the House Study Group Bill Analysis; and 7) the House Business and Commerce Committee Bill Analysis. Evidence of legislative intent of the 1987 and 1991 amendments comes from: 1) the Senate Economic Development Committee Hearing, H.B. 418, April 24, 1987; 2) the House Business and Commerce Committee Hearing, H.B. 278, February 25, 1991; and 3) the House Business and Commerce Committee Bill Analysis, H.B. 278.

59. Tex. S.B. 142, 66th Leg., R.S. (1979) was the Senate version of the bill that eventually became 5.10(B).

60. *The Disposition of Assets of a Corporation and Certain Corporate Mergers: Hearings on Tex. S.B. 142 Before the Senate Subcomm. on Civil Matters*, 66th Leg., R.S. Tape (Jan. 30, 1979) [hereinafter *Tape of Senate Subcomm. on Civil Matters*] (transcript on file with the *Texas Wesleyan Law Review*).

Ogg: [An Austin court of appeals case applied] "the old common law doctrine of de facto merger"—"that is if you buy an asset of a corporation you really in effect merge the two corporations and you take on all the hidden liabilities of the corporation even though you may have only bought just one asset . . . " now this bill would allow a corporation to statutorily purchase those assets . . . they would have to comply with other protections such as the bulk sales act and the other protections . . . .

introduction, however, misinterpreted the *Gerhardt* decision.[61] Ogg told the Subcommittee that merely purchasing a single asset from a corporation would make the purchaser liable for hidden liabilities of the seller, and that legislation was needed to prevent this "old common law" doctrine from producing such unfair results.[62] Ogg also assured the Subcommittee that creditor protection provided under bulk sales law would not be impaired.[63]

The Subcommittee then heard testimony in support of the bill from Mr. Boone of the State Bar of Texas.[64] Mr. Boone told the committee "notwithstanding the fact that the court found that the [W. R. Life] transaction had complied with article 5.10(A), the corporation was required to assume the liabilities of [the seller]."[65] Mr. Boone supported Senator Ogg's position that the *Gerhardt* decision necessitated passage of S.B. 142 thereby amending article 5.10.[66]

However, Mr. Boone made no mention of the various necessary factual elements used by the *Gerhardt* court to determine that a transaction is a *de facto* merger.[67] Mr. Boone made no mention of the fact the court acknowledged the general rule that a mere purchase of assets alone does not make a purchaser liable for the debts of a seller.[68] Further, Mr. Boone *added* facts to the *Gerhardt* decision by stating the court found "compliance with 5.10(A)," and notwithstanding that compliance, found a *de facto* merger had indeed occurred.[69] Apparently, relying on Mr. Boone's and Senator Ogg's interpretation of *Gerhardt*, together with the plain language of the bill, the Subcommittee favorably reported the bill back to the full Senate Jurisprudence Committee.

Senator Ogg then presented S.B. 142 to the full Senate Committee on Jurisprudence, stating "[i]t has to do with the doctrine of *de facto* merger of corporations. And there is a lawsuit that this legislation is attempting to cure . . . ."[70] Senator Ogg represented to the Committee

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Id.

61. Western Resources Life Ins. Co. v. Gerhardt, 553 S.W.2d 783, 786 (Tex. Civ. App.—Austin 1977, writ ref'd n.r.e.).

62. *Tape of Senate Subcomm. on Civil Matters*, *supra* note 60.

63. *Id.*

64. *Id.*

65. *Id.*

66. *Id.*

67. *An Act Relating to Disposition of Corporate Assets, Derivative Suits Against a Corporate Merger: Hearings on Tex. S.B. 142 Before the Senate Comm. on Jurisprudence*, 66th Leg., R.S. Tape (Feb. 6, 1979) [hereinafter *Tape of Senate Jurisprudence Comm.*] (transcript on file with the *Texas Wesleyan Law Review*).

68. *Gerhardt*, 553 S.W.2d at 786.

69. *Tape of Senate Comm. on Jurisprudence*, *supra* note 67.

70. *Tape of Senate Comm. on Jurisprudence*, *supra* note 67.

Chairman: At this time, the chair will lay out Senate Bill 142 which has been reported from the Subcommittee on Civil Matters and recognize Senator Ogg.

that "if you buy a corporation [under Gerhardt] it can be considered a merger and can leave you opened to [a lawsuit]."[71]

However, Senator Ogg's introductory remarks to the Jurisprudence Committee did not set forth the elements required for determining a *de facto* merger, and thereby misstated the nature of the problem that the legislation was intended to cure. Senator Ogg told the Committee the bill had the support of the State Bar and there was no objection to the bill.[72] Moreover, no one asked questions, and the entire procedure lasted only two or three minutes. The Committee then passed the bill to the full Senate with recommendation for passage.[73]

The full Senate considered S.B. 142 on April 23, 1979, which Senator Ogg again introduced.[74] The transcript of the reading indicates the

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Ogg: Mr. Chairman and members, this is a bill that came out of Senator Braeckleins' Civil Jurisprudence Subcommittee last week. It has to do with the doctrine of de facto merger [sic] of corporations. And there is a law suit that ah - this legislation is attempting to cure and it is a situation where if a derivative suit lies, if you have a merger that you don't, in fact, the merging corporation doesn't buy that law suit, under the present case law, there is a case where that is allowed and if you buy a corporation it is considered, it can be considered a merger and can leave you open to that.
Now Senator Doggett and I ah - have talked about another bill that he has that represents, that would in affect [sic] let creditors do the same thing. And I think what we're going to try to do, if the committee is willing, is to go ahead and get this bill passed out as a vehicle and hopefully within two weeks we're going to see if we can merge these two bills. This bill as it is before this committee is a bill that comes from a section of the State Bar Association and I know of no opposition to it, there hasn't been any, nor do we know of any.
Chairman: Are there questions of Senator Ogg? If not, are there anyone, is there anyone who desires to testify for or against Senate Bill 142? If, ah - Senator Doggett moves that Senate Bill 142 be reported back to the Senate with a favorable recommendation that it do pass and be printed. All those in favor say aye, those opposed say nay. Secretary call the roll.
Secretary: (Roll Call)
Chairman: There being 7 votes for and no votes against, Senate Bill 142 will be so reported.
Ogg: Mr. Chairman, just so I didn't misstate anything, I think ah - Senator Doggett may, we may try to use that plan or he may want to bring his own bill out and we'll have both bills and try to merge it. But, under whatever, plan, we're trying to work those two together if we can.
(End of discussion of S.B. 142).

Id.

71. *Id.*

72. *Id.*

73. *Id.*

74. Debate on Tex. S.B. 142 on the floor of the Senate, 66th Leg., R.S. Tape 1, side 1 (Apr. 23, 1979) (transcript on file with the *Texas Wesleyan Law Review*).

President: The Senator from Harris, Senator Ogg.
Ogg: Members, I would like to bring up out of its regular order, Senate Bill 142, and ask that the, that all rules be suspended. That is a rule that involved derivative lawsuits, de facto [sic] mergers in derivative law suits that Senator Schwartz and I discussed early in the Session. We have amended the section that Senator Schwartz objected to and have take [sic] it totally out of the bill and as far as I know, now there is no objection to it.

discussion was extremely short and again misrepresented *Gerhardt*'s reasoning and the nature of the *de facto* merger doctrine.[75] When Senator Patman asked Senator Ogg why the bill was necessary, Senator Ogg stated it was necessary to prevent the purchase of corporate assets from being deemed a *de facto* merger by a court.[76] Senator Ogg's explanation of the bill's necessity again implied that the

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Patman: Will the Senator yield for a question? Okay. What, what does the bill do then? Would you refresh our memory about it?

Ogg: This the one relating to de facto [sic] merger and as we . . . Well, it says that, that in effect if you have a, if you purchase corporate assets, that it does not amount to a de facto [sic] merger. That the creditors have all their ordinary rights that they have under the present law, including criminal rights, Senator, including the rights of bankruptcy, including those things.

Patman: Alright.

Ogg: We took out the part about the derivative lawsuit.

Patman: Just for the history of this thing, there is no intention that will deprive anybody of any right . . . that he present [sic] has . . . under this.

Ogg: No. Of course not.

Patman: Thank you.

President: The Senator from Harris ask [sic] unanimous consent to take up Senate Bill 142. Is there objection? Chair hears none, lay out Senate Bill 142 on second reading. Secretary read caption.

Secretary: Senate Bill 142 relating to disposition of assets of a corporation. (Amendment entered striking section 2 of the bill and renumbering subsequent sections accordingly)

President: (After adoption of the amendment). The chair lays out Senate Bill 152 [sic] [142] on third reading and final passage, Secretary read the caption.

Secretary: Senate Bill 142 relating to disposition of assets of a corporation.

President: The Senator yields.

Patman: Senator, just a couple of other questions. Will this bill be amended in the House to put back in what Senator Schwartz and I objected to?

Ogg: Well as far as I'm concerned, Senator, we have a, you know, that's the—situation we're in and I don't intend to try to do that.

Patman: Alright. Second question, what is the need for the bill?

Ogg: Because of a lawsuit, Senator, let me get you the style of it. There was a lawsuit, Western Reserve Life Insurance Company versus Gerhardt, that came out of the Austin Court where in a purchase was held to be a de facto [sic] merger and that's what this attempts to do is keep it from being a de facto [sic] merger. And it statutorily clears up the problem that that lawsuit created.

Patman: All right, if it is a de facto merger [sic], what happens to the rights of the parties?

Ogg: If it is not a de facto merger [sic], they're just as they are now. If it in fact, would be a de facto [sic] merger then, someone coming in purchasing the assets of a corporation, a third party would also be subject to the creditor and it would give creditors new rights. That [sic] what, what a de facto [sic] merger would do and what this attempts to do is keep both parties in their place.

Patman: Thank you.

(Roll Call - S.B. 142 Passes).

Id.

75. *Id.*

76. *Id.*

Gerhardt court had found a mere purchase of assets to be a *de facto* merger.

Looking next at the material from the House of Representatives, there is no evidence the majority of the House intended to statutorily overturn *Gerhardt*. After the House sent the matter to the House Committee on Business and Industry, the Committee held its first hearing on H.B. 387 and companion S.B. 142 on February 5, 1979. Representative Danny Hill, H.B. 387's sponsor, introduced the bill and referred to "the material that is in front of you."[77] Representative Hill then turned the presentation over to Mr. Boone of the State Bar.[78] No further description of the material was given on tape, but the material in the Bill File dated on or before February 5, 1979 includes only the text of the bill.

Mr. Boone's opening remarks were essentially the same as those he made to the Senate Subcommittee on Civil Matters.[79] However, there was additional discussion as Representative Allee questioned Mr. Boone extensively regarding the substance and reasoning of *Gerhardt*.[80]

The bill was then referred to subcommittee, however, there is no tape or transcript of the subcommittee hearing. H.B. 387 was reported back from subcommittee on February 26, 1979 along with a report.[81] There was no further debate at the February 26, 1979 hearing and the bill was recommended to the House floor for passage.

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77. *An Act Relating to Disposition of Corporate Assets, Derivative Suits, and Certain Corporate Mergers: Hearings on Tex. H.B. 387 Before the House Committee on Business and Industry,* 66th Leg., R.S. Tape (Feb. 5, 1979) [hereinafter *Tape of the House Bus. & Ind. Comm.*] (transcript on file with the *Texas Wesleyan Law Review*).

78. *Id.*

79. *Id.*

80. In the exchange between Mr. Boone and Mr. Allee, Mr. Allee pointed out the essential elements that *Gerhardt* used to determine a *de facto* merger. Mr. Allee further questioned whether any further legislation was necessary in light of the fact that a mere purchase of assets would not be a *de facto* merger. Mr. Boone did not directly respond to Mr. Allee's questions but generally argued that legislation was needed to assure that 5.10(A) would not be interpreted by future courts as a *de facto* merger given the fact that *Gerhardt* had recognized the *de facto* merger doctrine for the first time in Texas. Mr. Boone repeatedly illustrated his argument with the example that a purchase of $1,000 worth of assets could carry with it the purchase of $1,000,000 worth of unexpected liabilities. Mr. Boone pointed out that this was not fair and would prevent mom and pop from being able to sell their corner drug store. Mr. Boone also pointed out that bulk transfer, fraudulent conveyance, and securities fraud would be adequate to protect creditors from abuse. *Id.*

81. HOUSE COMM. ON BUS. AND INDUS., BILL ANALYSIS, Tex. S.B. 142, 66th Leg., R.S. (1979). On the tape there is no substantive discussion and the bill was passed after a cursory introduction with the recommendation "do pass." *Tape of the House Bus. & Ind. Comm., supra* note 77.

> Background Information The first and most substantive amendment concerns ARTICLE 5.10.A of the TBCA which governs the sale of "all or substantially all" of the assets of a Texas corporation. This statutory provision does not require that the acquiring corporations assume or otherwise become liable for the liabilities of the corporation whose assets are purchased.

There is no tape or transcript of the House floor debate on either S.B. 142 or H.B. 387. There is no evidence that the House membership heard any comment or debate from anyone, including either Mr. Boone or Mr. Allee. Therefore, the House membership appears to have been provided with no more than the plain language of the final bill and its two reports. The first report was the Bill Analysis of the Business & Industry Committee,[82] and the second report was prepared by the House Study Group.[83]

In contrast, when there is a statutory merger (pursuant to ARTICLES 5.02 or 5.01 of the TBCA), ARTICLE 5.06 of the TBCA provides that the surviving corporation is liable for all obligations of the merged corporation. Due to the statutory assumption of liabilities in a merger, purchasers often negotiate purchase of asset transactions pursuant to ARTICLE 5.10. A. in order to avoid becoming liable for liabilities which are not contemplated by the purchaser in negotiating the acquisition. However, under the *de facto* merger doctrine, as announced in the recent case of Western Resources Life Insurance Co. v. Gerhardt, an acquiring corporation pursuant to ARTICLE 5.10.A. can be held responsible for all liabilities of a selling corporation notwithstanding the absence of a contractual agreement to assume such liabilities or even if such assumption is contractually negated. Thus certain inequities are imposed upon an acquiring corporation in such circumstances . . . .

Purpose The purpose of SECTION 1 of this bill affecting ARTICLE 5.10B. is to preclude or stop the application of the doctrine of *de facto* merger in any sale, lease, exchange or other disposition of all or substantially all the property and assets of a corporation requiring authorization under Article 5.10.A. However, by expressly excepting from the operation of section B. the effect of "any other statute of this State", the statutory liabilities of an acquiring corporation under the bulk sales or fraudulent conveyance laws or similar statutes are left intact . . .

Section by Section Analysis. Section 1: Amends Article 5.10, Texas Business Corporation Act, as amended, by adding a new Section B which precludes the doctrine of *de facto* merger in any sale, lease, exchange or other disposition of all or substantially all the property and assets of a corporation under Article 5.10.A. It further expressly excepts from Section B. the effect of any other statute of this state. Thus, the statutory liabilities of an acquiring corporation under the bulk sales or fraudulent conveyances laws are left intact.

82. *Id.*

83. HOUSE COMM. ON BUS. AND INDUS., Bill Analysis, Tex. H.B. 387, 66th Leg., R.S. (May 1, 1979).

Subject: Corporations
Committee: Business and Industry: favorable, with amendments
Vote: 9 Ayes — Semos, McCleod, Polumbo, Allee, Glossbrenner, A. Hill, Lee, Robnett, Waters
0 nay
0 present, not voting
2 absent — Bush, S. Thompson
Witnesses: For — Michael Boone, State Bar of Texas
Against — None

Digest: This bill amends the [Texas] Business Corporations Act to make it clear that the sale of all or substantially all of the assets of a corporation with shareholder approval shall not be considered a "de facto [sic] merger . . . ."

Pro: This bill makes it clear that the doctrine of "de facto [sic] merger" shall not apply to the sale of corporate assets under the act. This will protect cor-

C. *Evidence of Legislative Intent from the 1987 and 1991 Amendments*

Any analysis of legislative intent of article 5.10(B) would be incomplete without discussing the 1987 and 1991 amendments. If a statute has been the subject of litigation, legislative amendments are presumed to have considered court decisions interpreting the statute.[84] Legislative amendments which construe or clarify prior statutes are strong evidence of legislative declaration of a statute's original meaning,[85] therefore, legislative amendments suggest ratification of prior court decisions.

The 1991 amendment, enacted through H.B. 278, was proposed in order to "conform the authorization requirements for a proposed sale of substantially all the assets of a corporation to the authorization requirements for a merger or share exchange."[86] The bill did not, however, purport to modify article 5.10 and makes no reference to any cases regarding *de facto* merger. Thus, the 1991 amendment is not further evidence of legislative intent to eliminate the *de facto* merger doctrine.

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porations who have acquired assets of another corporation in compliance with the act from being saddled with unexpected and unknown liabilities of the other corporation.

Con: No apparent opposition.

Commentary: The [Texas] Business Corporations Act covers both the merger and disposition of corporate assets. These are two separate and distinct transactions and are covered by different rules and regulations.

A merger includes the merging of the property, assets, and stock of participating corporations. The surviving corporation inherits all of the liability of the merged corporation. A corporation may also sell or otherwise dispose of corporate property or assets, with shareholder approval. However, the acquiring corporation assumes only as much of the liabilities of the disposing corporation as it contractually agrees to accept.

The doctrine of "defacto [sic] merger" has been used to hold that when the terms of an acquisition of corporate assets so closely resemble the terms of a merger that the transaction will be deemed a "defacto [sic] merger." This makes the acquiring corporation liable for all of the debts of the disposing corporation, notwithstanding any contractual provisions to the contrary. The doctrine has been done away with in most states, and it was thought that the doctrine did not apply to the disposition of corporate assets under the Texas [Business Corporation] Act. However, in *Western Resources Life Ins. Company v. Gerhardt*, 553 S.W.2d 783 (Tex. Civ. App.—Austin, 1977) the court applied the doctrine of "defacto [sic] merger" to a transfer of corporate shares and assets. It prevented the corporations from avoiding liability through corporate transformations or changes in form only. This bill makes it clear that the disposition of corporate assets and property under the act is not to be considered a "defacto [sic] merger."

(Sections of the report not related to *de facto* merger have been omitted).

Id.

84. Sutherland Stat. Const. § 22.31 (5th ed. 1991).

85. *Id.*

86. HOUSE COMM. ON BUS. AND COMMERCE, BILL ANALYSIS, Tex. H.B. 278, 72nd Leg., R.S. (1991).

The 1987 amendment, however, requires a more detailed analysis. H.B. 418, passed by the 70th Legislature, revised the language of article 5.10(B) by removing the phrase "or consolidation" from the enacted language.[87] This is evidence of legislative intent, since the entire sentence could have been deleted, but instead the prohibition against deeming an article 5.10(A) transaction a merger was retained.[88] Additionally, at the time of the amendment, the Corpus Christi Court of Appeals refused to apply the *de facto* merger doctrine based on article 5.10(B).[89] As previously noted, under the rules of statutory construction, any cases between 1979 and 1987 concerning *de facto* merger were presumptively considered in enacting the amendment.[90]

However, this presumption is undermined on two counts. First, case history is extremely short and mixed.[91] Second, although the Bill Analysis of H.B. 418 states that the legislative intent was to reaffirm the preclusion of *de facto* merger, the hearing tapes and transcripts make no mention of intervening cases nor any discussion or debate of article 5.10's application since the time of its original amendment.[92] The focus of the testimony and discussion in 1987 was on H.B. 418's provision allowing corporate directors to be indemnified for costs and attorney's fees in derivative actions.[93] The *de facto* merger doctrine was never discussed. Therefore, the 1987 amendment's evidentiary value is minimal.

D. *Applying the Rules of Statutory Construction to the Evidence of Legislative Intent*

1. The Plain Meaning Approach

The plain language of 5.10(B) is short and easily reduced to simple terms. The plain language should therefore be considered as the first, but not the only, evidence of legislative intent. Section 5.10(B) states:

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87. HOUSE COMM. ON BUS. AND COMMERCE, BILL ANALYSIS, Tex. H.B. 414, 70th Leg., R.S. (1987).

88. *Id.*

89. *See* Mudgett v. Paxson Mach. Co., 709 S.W.2d 755 (Tex. App.—Corpus Christi 1986, writ ref'd n.r.e.) (upholding summary judgment without an analysis of the transaction's characteristics, since *de facto* merger is statutorily precluded by article 5.10(B)).

90. Sutherland Stat. Const. § 22.31 (5th ed. 1991).

91. *See* Suarez v. Sherman Gin Co., 697 S.W.2d 17 (Tex. App.—Dallas 1985, writ ref'd n.r.e.) (holding the facts did not constitute a *de facto* merger regardless of art. 5.10 (B)); *but see* Wall v. Owens-Corning Fiberglas Corp., 602 F. Supp. 252, 255 (N.D. Tex. 1985) (following *Gerhardt*, the court held a purchasing corporation cannot escape the liability of the transferee if the transaction is tantamount to a merger).

92. *An Act Relating to the Incorporation, Organization, Operation, Reorganization, and Dissolution of Certain Corporations-Providing a Criminal Penalty: Hearings on Tex. H.B. 418 Before the House Comm. on Business and Commerce*, 70th Leg., R.S. Tape (March 23, 1987) (tape on file with the *Texas Wesleyan Law Review*).

93. *Id.*

> A disposition of all, or substantially all, of the property and assets of a corporation requiring the special authorization of the shareholders of the corporation under Section A of this article:
> (1) is not considered to be a merger or consolidation pursuant to this Act or otherwise; and
> (2) Except as otherwise expressly provided by another statute, does not make the acquiring corporation responsible or liable for any liability or obligation of the selling corporation that the acquiring corporation did not expressly assume.[94]

In analyzing this language, it is first helpful to eliminate the contingent clauses and parse the single compound sentence. If you do so, the sentence becomes: A disposition of all of a corporation's property is not a merger pursuant to this act or otherwise; and: A disposition of all of a corporation's property does not make the acquiring corporation liable for the [debts] of the selling corporation. However, the phrase *or otherwise* requires consideration of additional materials to clarify its meaning. A review of these additional materials reveals that *or otherwise* refers to the common law doctrine of *de facto* merger.[95] Then, the parsed sentence becomes: A disposition of all of a corporation's property is not a merger pursuant to this act or pursuant to the common law doctrine of *de facto* merger.

The extra-textual material is also consistent with the view that the statute merely sought to clarify the status of transactions undertaken pursuant to 5.10(A). As the House Committee on Business and Commerce Report states, "[t]his bill makes it clear that the doctrine of '*de facto* merger' shall not apply to the sale of corporate assets under the act."[96] Morever, clarifying certain rights and responsibilities of interested parties under 5.10(A) does not provide a basis to broadly interpret 5.10(B) as meaning that a *de facto* merger may not apply even when all the additional facts and circumstances needed to find a *de facto* merger are present in a transaction.

Having demonstrated the phrase *or otherwise* refers to *de facto* merger, the plain langauge of the 1979 version of article 5.10(B) states nothing more than that a purchase of substantially all of a corporation's assets is not by itself a merger and does not make the purchasing corporation liable for the debts of the selling corporation. Thus, the plain language of article 5.10(B) did nothing more than codify the common law rule that a mere purchase of corporate assets does not constitute a merger and does not make the purchasing corporation liable for the debts of the selling corporation.[97] This is the same rule used in jurisdictions recognizing *de facto* merger.[98] Thus, courts

94. TEX. BUS. CORP. ACT ANN. art. 5.10(B) (West 1980).
95. *See supra* notes 77, 80 and accompanying text.
96. HOUSE COMM. ON BUS. AND COMMERCE, Bill Analysis, *supra* note 83.
97. Knapp v. North Am. Rockwell Corp., 506 F.2d 361, 363-64 (3d Cir. 1974), *cert. denied*, 421 U.S. 965 (1975).
98. Shannon v. Samuel Langston Co., 379 F. Supp. 797, 800 (W.D. Mich. 1974).

should find more than a mere purchase of assets to reach the conclusion that a *de facto* merger has occurred.[99] The plain language approach unambiguously allows the statute to be interpreted consistently with the rule of law followed in jurisdictions recognizing the *de facto* merger doctrine. But for the Texas rule, requiring further inquiry into legislative intent, this analysis could stop with the plain language of the statute.

2. The Context Approach

Mr. Boone of the State Bar provided insight into the broader business and legal context of the State Bar's request for the amendment. Although Mr. Boone did not testify before the full Senate or House, his testimony before their subcommittees is illuminating. Mr. Boone testified that Texas corporate lawyers customarily structure transactions with full knowledge that they have two alternative structures from which to choose: 1) merger under section 5.06; or 2) sale of assets under Section 5.10(A).[100] Mr. Boone stated that moms and pops typically sell corner drug stores in sale of asset transactions rather than merger transactions because buyers do not want to assume liabilities beyond those bargained for.[101] Boone also stated that if sale of asset transactions could not be accomplished, then no one would purchase mom and pop corner drug stores because purchasers would be afraid of taking on hidden liabilities.[102] Furthermore, Mr. Boone stated sale of asset transactions provide creditors protection under the Bulk Sales Act, Fraudulent Conveyance Act, or securities fraud law.[103]

The essence of Mr. Boone's testimony was incorporated into the Business and Industry Committee Bill Analysis which was sent to the House and Senate. The report states, "[d]ue to the statutory assumption of liabilities in a merger, purchasers often negotiate purchase of asset transactions pursuant to ARTICLE 5.10 A in order to avoid becoming liable for liabilities which are not contemplated by the purchaser in negotiating the acquisition."[104]

Mr. Boone's testimony reflects policy considerations which are discussed later in this article.[105] His testimony also sheds light on 5.10 B's legislative intent. For example, Mr. Boone acknowledged the need to prevent fraud or unfairness to creditors.[106] Mr. Boone's ex-

99. *Id.* at 801. (To conclude de facto merger a court must find four factors, (1) Continuation of the enterprise, (2) Continuity of shareholders, (3) Seller ceases its ordinary business, (4) Purchaser assumes liabilities necessary for continuation.).
100. *See supra* note 80 and accompanying text.
101. *Id.*
102. *Id.*
103. *Id.*
104. *Id.*
105. *See* discussion *infra* pp. 615-26.
106. *See supra* note 80 and accompanying text.

changes with Mr. Allee demonstrate that at least some members of the committee recognized that *Gerhardt* found more than a mere purchase of assets when it deemed the W. R. Life transaction a *de facto* merger.[107] Mr. Allee clearly wanted assurance that when these additional facts are present, the proposed legislation would not prevent their consideration in determining whether a merger occurs.

The legislation's context supports the view that the plain language of section B was narrowly tailored to allow legitimate purchase of asset transactions to occur without being deemed *de facto* mergers. However, this context does not justify the broader interpretation that there is no *de facto* merger even when all the facts and circumstances exceeding a sale of assets are present.

One final comment is justified. Neither Mr. Boone nor the Committee Report distinguishes between a transaction in which corporate assets are sold to a stranger who remains a stranger after a cash transaction, and a transaction in which former shareholders, directors, and officers of the selling corporation become part of the purchasing corporation, thus retaining control of the assets and an ownership interest in the future income generated after the transfer. This is an important evidentiary consideration which should not be overlooked in evaluating legislative intent of 5.10(B).

3. The Legislative Process Approach

The last step in determining whether the Legislature intended to exceed the plain language of 5.10(B) requires examination of the mechanics of the legislative process leading to its enactment. This raises the question whether there was any debate or extra-textual material that the House and Senate were provided evidencing their intent to go beyond the plain language of the bill before them. Remembering the possibility that special interest groups operate to influence legislation, we should look at whether the extra-textual material provided to the House and Senate membership was misleading, causing members to vote for a bill they otherwise may not have supported.

To become law in Texas, a bill must pass the House and Senate by majority vote and then be signed into law by the Governor.[108] To find legislative intent beyond the plain language of a statute requires not only evidence of what one small group of legislators or outside witnesses intended, but clear evidence of what the majority of the House and Senate intended. Thus, to form intent beyond the plain language of a statute presumes that the majority actually considered or debated the material alleged to evidence the extra-textual intent.

107. *Id.*
108. TEX. CONST. art. IV, § 14.

In this instance, there is no evidence of any debate on the House floor. The absence of debate must be interpreted as an absence of extra-textual intent. Any other interpretation requires speculation whenever a statute is relevant to determining an issue.

The only evidence of extra-textual intent comes from the reports contained in the Bill File. It is reasonable to assume that the House membership relied on these reports and voted for the bill accordingly. Given the contents of the reports, the resulting legislation should be interpreted to intend a cure for the problem set forth in the reports and no more. Yet, the Study Group Report states, "[t]his bill makes it clear that the doctrine of '*de facto* merger' shall not apply to the sale of corporate assets under the act."[109] This language can not be interpreted as a broad rejection of the *de facto* merger doctrine. The language should more appropriately be interpreted as clarification of the effect of an article 5.10 transaction.

After reviewing the House Study Group Bill Analysis, it is apparent that the members of the House were provided with a report favorably recommending the bill, but at the same time fundamentally misrepresenting the findings, reasoning, and holding of *Gerhardt*. The report states, "[t]he doctrine of '*de facto* merger' has been used to hold that the terms of an acquisition of corporate assets so closely resemble the terms of a merger that the transaction will be deemed a '*de facto* merger.'"[110] This was not the *Gerhardt* holding.

The general rule of *de facto* merger, announced in *Gerhardt*, is that if the terms of an acquisition of corporate assets so closely resembles the terms of a merger, then the transaction will be deemed a *de facto* merger.[111] Thus, deeming a particular transaction a *de facto* merger depends entirely on finding other facts and circumstances regarding the transaction. Therefore, the Study Group Report had the capacity to mislead the House members into believing that a mere acquisition of corporate assets under 5.10(A) by itself was deemed a *de facto* merger by the *Gerhardt* court.

This view is further supported by examing the Business and Industry Committee's Bill Analysis. That report also misinterprets the reasoning and holding of *Gerhardt*, and wrongly advised the House:

> [U]nder the *de facto* merger doctrine, as announced in the recent case of *Western Resources Life Insurance Co. v. Gerhardt*, an acquiring corporation pursuant to ARTICLE 5.10 A. can be held responsible for all liabilities of a selling corporation notwithstanding the absence of a contractual agreement to assume such liabilities or even if such assumption is contractually negated. Thus certain ineq-

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109. HOUSE COMM. ON BUS. AND COMMERCE, BILL ANALYSIS, *supra* note 83.

110. *Id.*

111. *See* Western Resources Life Ins. Co. v. Gerhardt, 553 S.W.2d 783, 786 (Tex. Civ. App.—Austin 1977, writ ref'd n.r.e.).

uities are imposed upon an acquiring corporation in such circumstances.[112]

Gerhardt simply did not reach such a conclusion and, in fact, never mentioned Article 5.10(A). Furthermore, *Gerhardt* explicitly rejected the notion that a purchase of corporate assets by itself imposes liability on a buyer.[113]

The Business and Commerce Report then advised the House membership that "[t]his statutory provision does not require that the acquiring corporations assume or otherwise become liable for the liabilities of the corporation whose assets are purchased."[114] Again, this language only clarifies Article 5.10 A's intent. A purchase of assets does not by itself carry with it the debts of the selling corporation.

It should be noted that the Business and Commerce Committee Report was the only report in S.B. 142's Bill File. The House Study Group Report is dated after the full Senate hearing on the matter, and therefore, was not considered by the Senate.[115]

Furthermore, there was a brief discussion between Senator Ogg and Senator Patman immediately before the vote. Senator Patman specifically asked Senator Ogg for assurances that no one would be deprived of any rights by the legislation.[116] The legislative intent must, therefore, be evaluated in light of the Senate's intent not to deprive anyone of their rights. Substantive law necessarily changes, and thus potentially deprives individuals of rights. Therefore, Article 5.10(B) may not be interpreted to change or deprive contingent creditors of any right of recovery from successor corporations where the elements of a *de facto* merger are present. Rather, 5.10(B) must be interpreted as a clarification of 5.10(A).

The Committee Reports and Mr. Ogg's statements to the Senate also assured the Senate that other statutes were adequate to protect creditors in the event of fraudulent or bulk transfers of assets.[117] As demonstrated below, fraudulent and bulk transfer law, although intended to protect creditors in corporate transfers, have numerous holes which leave contingent creditors vulnerable to injustices.[118] Prior to this legislation, creditors clearly had a right to recover the value of a judgment from corporate assets transferred in a true *de facto* merger. But interpreting 5.10(B) in such a way as to statutorily eliminate *de facto* merger in all circumstances deprives contingent creditors of their right to recover such judgments from corporate as-

112. HOUSE COMM. ON BUS. AND COMMERCE, BILL ANALYSIS, *supra* note 86.
113. *Gerhardt*, 553 S.W.2d at 786-87.
114. HOUSE COMM. ON BUS. AND COMMERCE, BILL ANALYSIS, *supra* note 86.
115. *Id.*
116. Debate on Tex. S.B. 142 on the floor of the Senate, *supra* note 74.
117. *Id.*
118. *See infra* pp. 619-23.

sets. Such an interpretation, therefore, goes against the legislative intent that creditors not be deprived of their existing rights.

In summary, the available extra-textual evidence is not sufficient to establish that the Legislature intended to preclude *de facto* merger when all of its elements are present. The remaining section of this comment examines policy considerations which further demonstrate that elimination of the *de facto* merger doctrine creates opportunities to defraud Texas contingent creditors. To argue the 66th Legislature intended to create such opportunities would lead to absurd results contradictory to the principles of statutory interpretation.[119] On the other hand, interpreting 5.10(B) as a clarification, strictly in accordance with its plain language, creates no absurd results and the statute should be so interpreted as such.

III. Policy Considerations

A. *General Considerations and Identity of the Parties*

Corporate organization has evolved for the purpose of taking on large scale activities beyond the economic means of the individual. Corporate law has since developed two central concepts. One is that the corporation, not the individual stock holders, enters into transactions with respect to the acquisition or disposition of corporate assets.[120] The other is that the corporation, not the individual stock holders, are liable for corporate debts.[121] Thus, creditors have limited recourse for recovery of debts against individual shareholders, officers, directors and employees.

Limited liability allows, and thereby encourages, business owners to engage in economic activity knowing their financial risk is limited to the amount of their capital contributions and retained earnings in the face of changing and unpredictable circumstances. Therefore, if a corporate enterprise does not generate adequate income to pay its expenses, corporate assets are exhausted, and the stockholder loses his investment, but no more.

However, shielding individual corporate owners from personal liability for corporate debt creates the potential for creditor abuse by corporate insiders. Creditors are abused when insiders transfer corporate assets, either to themselves or to other corporate entities they control, and fail to pay the corporation's current creditors or fail to make provisions to pay contingent creditors. Both the assets and income generated by the transferred assets become unavailable to creditors, absent some legal remedy allowing them to recover from either the transferor or the transferee.

119. Jesulaitus, *supra* note 32, at 212.
120. Tex. Bus. Corp. Act Ann. art. 2.02 (West 1980 & Supp. 1996).
121. Tex. Bus. Corp. Act Ann. art. 2.21 (West 1980 & Supp. 1996).

> When use of the corporate form of business organization first became widespread, it was relatively easy for courts to define a 'merger' or a 'sale of assets' and to label a particular transaction as one or the other. But prompted by both the desire to avoid the impact of adverse, and obtain the benefits of favorable, government regulations, particularly federal tax laws, new accounting and legal techniques were developed by lawyers and accountants which interwove the elements characteristic of each, thereby creating hybrid forms of corporate amalgamation. Thus, it is no longer helpful to consider an individual transaction in the abstract and solely by reference to the various elements therein determine whether it is a 'merger' or a 'sale'. Instead, to determine properly the nature of a corporate transaction, we must refer not only to all the provisions of the agreement, but also to the consequences of the transaction and to the purposes of the provisions of the corporation law said to be applicable.[122]

De facto merger is an equitable creditor's remedy, and there obviously is substantial dispute as to whether that remedy should be available to Texas creditors.[123] Texas enjoys a reputation for being friendly to debtors largely due to its liberal homestead and personal property exemptions.[124] While Texas may be generous in allowing individuals a fresh start when their economic circumstances have become hopeless, Texas law seeks to prevent outright fraud against creditors.[125] Texas law also seeks to protect those who purchase corporate assets in good faith for reasonable value, commonly known as bona fide purchasers ("BFPs").[126] This protection is accomplished by providing defenses and other relief to BFPs if the subject property is claimed by a former owner's undisclosed creditor.[127]

To more closely examine the policy behind *de facto* merger, the potential parties and their interests in the transaction must be identified. The parties' respective rights and their ability to foresee, avoid, or insure against potential damages or imposition of liability must be considered. Further, the relative culpability of each party in the transaction or the underlying creditor claim must also be consid-

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122. Farris v. Glen Alden Corp., 143 A.2d 25, 28 (Pa. 1958) (citations omitted).

123. *See* Western Resources Life Ins. Co. v. Gerhardt, 553 S.W.2d 783 (Tex. Civ. App.—Austin 1977, writ ref'd n.r.e.); Wall v. Owens-Corning Fiberglas Corp., 602 F. Supp. 252 (N.D. Tex. 1985); *but see* Aguirre v. Armstrong World Indus., 901 F.2d 1256 (5th Cir. 1990); Suarez v. Sherman Gin Co., 697 S.W.2d 17 (Tex. App.—Dallas 1985, writ ref'd n.r.e.); Mudgett v. Paxson Mach. Co., 709 S.W.2d 755 (Tex. App.—Corpus Christi 1986, writ ref'd n.r.e.); Castilla v. Trinity Indus., 626 S.W.2d 798 (Tex. App.—San Antonio 1981, writ dism'd).

124. *See, e.g.,* TEX. PROP. CODE ANN. § 42.001 (West 1984 & Supp. 1996).

125. *See, e.g.,* TEX. BUS. & COM. CODE ANN. §§ 24.001-.012 (West 1987 & Supp. 1996).

126. *See* TEX. BUS. & COM. CODE ANN. § 24.009 (West 1987 & Supp. 1996).

127. *Id.*

ered.[128] In turn, each of these factors must be weighed to obtain a proper determination of the legal protection provided each party. The parties in interest to such transactions are the transferor, the transferee, and creditors.

Who is a transferor? The obvious answer is that a transferor is the corporation that formerly owned the assets. This obvious answer, however, is clouded by the fact that a corporation is a legal fiction. The real parties in interest are the shareholders who own the stock of the transferring corporation. Thus, a slightly broader definition of transferor is needed, including shareholders, directors, and officers of the transferring corporation, particularly those who were instrumental in negotiating the transaction, and especially those who become officers and directors of the transferee. Therefore, this author defines a transferor as any party who may be defined as an insider of the selling corporation under the various statutory definitions of an insider.[129]

Next, transferees must be defined. As is the case with transferors, the fictional corporate entity is not the legitimate focus of any policy analysis because it is a legal fiction, and has no human needs, but merely serves as a conduit which ultimately serves human needs. Again, any definition of transferees should include shareholders who own stock and are thereby financially impacted by any change in the value of their stock due to imposition of liability for debts. In addition, transferees should include directors, officers, or other individuals associated with the purchaser who orchestrated the transaction, particularly those who remain in positions of authority and control over the purchased assets in the combined corporate entity.

Finally, creditors must be defined. Under the Uniform Fraudulent Transfer Act[130] a creditor is defined as "a person, including a spouse, minor, or ward, who has a claim."[131] A claim is defined as "a right to payment or property, whether or not the right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured."[132] Although this definition includes contingent creditors, it will be demonstrated that the Uniform Fraudulent Transfer Act from which it

128. Lincoln Nat'l Life Ins. Co. v. Brown Schs., 757 S.W.2d 411, 415 (Tex. App.—Houston [14th Dist.] 1988, no writ) ("Restitution for money paid under mistake of fact is simply an equitable limitation that places the loss, as between two innocent parties, on the one who has created the situation and was in the best position to have avoided it.").

129. *See, e.g.*, TEX. BUS. & COM. CODE ANN. § 24.002(7)(B) (West 1987) (under the Fraudulent Transfer Act an "insider" of a corporation includes: i) a director of the corporation; ii) an officer of the corporation; iii) a person in control of the corporation; iv) a partnership in which the corporation is a general partner; v) a general partner in a partnership described in subparagraph (iv); and vi) a relative of a general partner, director, officer, or person in control of the corporation).

130. TEX. BUS. & COM. CODE ANN. §§ 24.001-.013 (West 1987 & Supp. 1996).

131. TEX. BUS. & COM. CODE ANN. § 24.002(4) (West 1987).

132. TEX. BUS. & COM. CODE ANN. § 24.002 (3) (West 1987 & Supp. 1996).

is derived actually affords contingent creditors little chance for recovery.[133]

B. De Facto *Merger Prevents Disguising Mergers to Avoid Creditors*

Defendants in *de facto* merger cases have sought to analogize the imposition of tort liability on successor corporations to an award of damages against an estate of a deceased wrongdoer, which is prohibited by Texas law.[134] However, Judge Sanders of the Northern District of Texas rejected this analogy:

> A successor corporation is unlike an estate in that the former has bargained for the assets of its predecessor. It may be, however, that the assets are encumbered by tort liabilities. The acquiring corporation cannot accept the good without the bad . . . and jettison inchoate liabilities into a never-never land of transcorporate limbo.[135]

Judge Sanders' statement highlights the central policy objection to disguising mergers as sale of asset transactions. Jettisoning unwanted liabilities by agreement between a buyer and seller, without agreement of affected creditors, violates basic notions of fairness as well as basic principles of contract law.

Any agreement between parties to a sale of asset transaction may have the practical result of a novation. In transferring rights and duties under a novation, "[t]he assent of the obligee is indispensable."[136] More importantly, any transfer of assets that incapacitates a transferor's ability to fulfill its obligations, without guaranteeing that an obligee will receive the perfomance to which he is entitiled, is an obvious injustice, in violation of novation law.

In some cases, the *de facto* merger doctrine is essential to remedy a transferor's breach of implied warranties of merchantibility and fitness, or for various other concealed tortious conduct. Without *de facto* merger, contingent creditors will be left without the ablility to recover from transferred assets. Therefore, when transactions bear the essential characteristics of a merger, Texas corporations should not be allowed to disguise merger transactions as a sale of assets transaction simply to avoid concealed liabilities.

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133. *See infra* pp. 619-23.

134. Wall v. Owens-Corning Fiberglas Corp., 602 F. Supp. 252, 255 (N.D. Tex. 1985).

135. *Id.*

136. E. ALLEN FARNSWORTH & WILLIAM F. YOUNG, CASES AND MATERIALS ON CONTRACTS 943 (4th ed. 1988). ("When an agreement is made for the substitution of one obligor for another, such that the obligee is entitled to the same performance, but the original obligor is released, the agreement is one of a class called 'novation.'") *Id.*

C. *Interpreting Article 5.10(B) to Preclude* De Facto *Merger Leads to Absurd Results*

An article 5.10(A) sale of asset transaction presumes an arms length transaction between a buyer and seller who go their separate ways after completing the transaction.[137] However, if: 1) the buyer continues the seller's business with essentially the same management and personnel under the buyer's name, or in the case of a consolidation, under a new, corporate name; 2) the owners of the buyer exchange shares of stock with the owners of the seller, and the owners of the sellers thereby become owners of the buyer; and 3) the seller goes out of business after the merger, then in reality the companies have merged despite contractual language to the contrary, and the buyer assumes those liabilities of the seller that enable the buyer to continue the seller's business.[138] *De facto* merger merely recognizes that the seller retains a continuing interest in the assets sold, and imposes continuing liability against the assets for debts incurred before the sale.

If a transaction has all the characteristics of a merger defined under article 5.01,[139] there is no harm in deeming the transaction a merger. In the case of statutory merger or share transfer, the parties agree to transfer all liabilities along with the assets under article 5.06.[140] The question then arises, did Texas Legislators intend to allow corporate executives to engage in transactions that have all the characteristics and benefits of a merger without assuming the liabilities normally associated with a merger? It is beyond reason to infer that Texas Legislators intended to leave the assumption of these debts to the sole discretion of corporate executives. Surely, the drafters of the Model Business Corporations Act and the Texas Legislators who adopted the statute did not intend to create two methods of accomplishing a merger; one method carrying with it the liabilities of the seller and the other method imposing no liability.

D. *Inadequacy of Fraudulent and Bulk Transfer Law as a Remedy for Contingent Creditors*

To prevent creditor abuse, Texas, like all jurisdictions, has created or adopted various common law and statutory remedies allowing creditors to seek relief from parties other than the debtor corporation. These laws and doctrines address intentional as well as unintentional corporate conduct. The principle statutory remedies available to these creditors, and those specifically referred to in the extra-textual material associated with article 5.10(B),[141] are the Uniform Fraudu-

137. TEX. BUS. CORP. ACT ANN. art. 5.10(A) (West 1980 & Supp. 1996).
138. *Id.*
139. TEX. BUS. CORP. ACT ANN. art. 5.01 (West 1980 & Supp. 1996).
140. TEX. BUS. CORP. ACT ANN. art. 5.06 (West 1980 & Supp. 1996).
141. HOUSE COM. ON BUS. AND COMMERCE, BILL ANALYSIS, *supra* note 86.

lent Transfer Act[142] and the Uniform Commercial Code-Bulk Sales Act.[143] Both Acts allow creditors under limited circumstances to void transfers and seek *in rem* relief against the assets transferred or seek damages against the transferee.[144] However, the Uniform Commercial Code-Bulk Sales Act has been repealed in Texas and no longer provides creditor protection.[145]

A creditor may also bring common law or statutory fraud claims for damages against insiders who improperly transfer assets. However, due to the fact the corporation, rather than the individual insiders, owns the assets, remedies against individual insiders will not result in substantial recovery unless they own other assets sufficient to pay damages. Where damages are large, individuals held liable will likely be unable to pay.

1. Fraudulent Transfers

Article 5.10(B) specifically allows the selling corporation's debts to be imposed on the buyer under the Texas Uniform Fraudulent Transfer Act.[146] The Uniform Fraudulent Transfer Act applies when corporate insiders intentionally attempt to evade known creditors by transferring assets out of a corporation to themselves or to other entities they control. The insiders may then enjoy benefits without encumbrance of previous debts.

Under the Uniform Fraudulent Transfer Act, a creditor may seek relief against a transferee and: 1) avoid the transfer to the extent necessary to satisfy the creditors claims; 2) obtain an attachment or other provisional remedy against the asset transferred; 3) obtain an injunction against any further transfer by the transferee; 4) obtain the appointment of a receiver to take charge of the asset transferred or other property of the transferee; 5) levy execution of a judgment on the assets transferred.[147]

However, the Act requires proof that: 1) the transferor intentionally sought to hinder, delay, or defraud a creditor of the debtor; or 2) that the transferor made the transfer without receiving reasonably equivalent value for the assets and was engaged in a business of transaction for which the remaining assets were unreasonably small or intended to incur debts beyond his ability to pay as they became due.[148]

142. TEX. BUS. & COM. CODE ANN. §§ 24.001-.013 (West 1987 & Supp. 1996).
143. Act of June 18, 1965, 59th Leg., R.S., ch. 721, 1965 Tex. Gen. Laws 109, *repealed by* Act of June 11, 1993, 73rd Leg., R.S., ch. 570, § 16, 1993 Tex. Gen. Laws 2098, 2145 (hereinafter TEX. BUS. & COM. CODE ANN. §§ 6.101-.111, *repealed by* 1993 Tex. Gen. Laws 2098, 2145).
144. *See* discussion *infra* pp. 620-23.
145. TEX. BUS. & COM. CODE ANN. §§ 6.101-.111, *repealed by* 1993 Tex. Gen. Laws 2098, 2145.
146. *See supra* notes 58, 83 and accompanying text.
147. TEX. BUS. & COM. CODE ANN. § 24.008 (West 1987).
148. TEX. BUS. & COM. CODE ANN. § 24.005 (West 1987 & Supp. 1996).

To prevail in either of these instances, a creditor must prove that the insiders had knowledge of his claim. One factor courts consider under the Uniform Fraudulent Transfer Act is whether the debtor has been previously sued or threatened with suit.[149] Since contingent creditors may not even know they have been damaged or have the opportunity to make a claim until some time after a transfer, it is relatively easy for a transferor and transferee to deny knowledge of liability.[150] This is true even though insiders have substantial reason to know the liabilty exists. Absent proof of the transferor's or the transferee's knowledge of liability, it is impossible to prove fraudulent intent. Thus, the fraudulent transfer remedy is generally worthless to contingent creditors.

To preserve a right of relief under the Uniform Fraudulent Transfer Act, all potential judgment creditors would have to notify all potential judgment debtors of their contingent claims in advance of the transfer of corporate assets and before the claims have matured. This is an impossible burden to place on tort claim plaintiffs whose causes of action are latent until an injury occurs or is discovered. Fraudulent transfer law is therefore an inadequate remedy for many and perhaps most contingent creditors.

2. Bulk Transfer Has Been Repealed and Can No Longer Protect Creditors

The sponsors of Article 5.10(B) promised the Legislature that creditors would be protected by bulk transfer law in 5.10(A) transactions.[151] However, the Bulk Transfer Act was repealed in 1993.[152] Under the previous statute, bulk transfer was defined as "any transfer in bulk and not in the ordinary course of the transferor's business of a major part of the materials, supplies, merchandise or other inventory of an enterprise . . . ."[153] Even though it no longer affords protection

149. TEX. BUS. & COM. CODE ANN. § 24.005(b)(4) (West 1987).

150. *See* Mudgett v. Paxson Mach. Co., 709 S.W.2d 755 (Tex. App.— Corpus Christi 1986, writ ref'd n.r.e.). In 1983, Mudgett brought a products liability suit for injuries he suffered from an industrial machine built by Paxson Machine some twenty years earlier. It is not uncommon for heavy industrial machines to have long lives. Paxson sold its assets to an apparently newly created corporation referred to by the court as Paxson II. Paxson I then changed its name to Thopax. Mudgett tried to sue Paxson II under a theory of *de facto* merger. The court granted summary judgment for Paxson II, interpreting 5.10(B) to preclude *de facto* merger. Since the summary judgment precluded further development of facts for the record as to whether the traditional *de facto* merger characteristics were present, it is not known whether Mudgett would have prevailed on his claims or not. However, the only relevant point to this part of the discussion is that certain claims can remain latent for extended periods of time, thus precluding proof of the knowledge and intent element in a fraudulent transfer claim.

151. HOUSE COM. ON BUS. AND COMMERCE, BILL ANALYSIS, *supra* note 86.

152. *See supra* notes 143, 145 and accompanying text.

153. TEX. BUS. & COM. CODE ANN. § 6.102, *repealed by* 1993 Tex. Gen. Laws 2098, 2415.

to creditors, it is nevertheless important to show bulk transfer law never adequately protected contingent creditors in any event.

The central purpose of bulk transfer law was to provide protection against two common forms of commercial fraud, namely:

> (a) The merchant, owing debts, who sells out his stock in trade to a friend for less than it is worth, pays his creditors less than he owes them, and hopes to come back into the business through the back door some time in the future. (b) The merchant, owing debts, who sells out his stock in trade to anyone for any price, pockets the proceeds, and disappears leaving his creditors unpaid.[154]

The first form of fraudulent conveyance is addressed under the Uniform Fraudulent Transfer Act.[155] The second form of fraud suggests a major bulk sales risk, and its prevention was the central purpose of the bulk sales law.[156]

Even before its repeal, bulk transfer law applied only to those enterprises whose principle business was the sale of merchandise from stock, including those that manufactured what they sold.[157] Thus, a plaintiff who was injured, for example, by professional malpractice could not seek relief under bulk transfer law. Further, a plaintiff's ability to recover from a transferee in a bulk transfer was limited to those plaintiffs who had known liabilities and who were not notified of the intended transfer in accordance with the statute.[158] Most importantly, no action or levy against the transferred assets could be brought more than six months after the transfer date.[159] Such a short statute of limitations, while adequate to protect creditors who are aware of their claims, is not realistic to protect contingent creditors who are damaged by long-lived defective products.

Since contingent creditors frequently have concealed or latent claims, which remain unknown to both transferors and transferees, thus precluding the perfection of a bulk transfer claim. The Bulk Transfer Act, even before its repeal, was therefore inadequate to protect contingent creditors.[160]

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154. U.C.C. § 6-101 cmt. 2(a), (b).

155. TEX. BUS. & COM. CODE ANN. § 24.001-.013 (West 1987 & Supp. 1996).

156. TEX. BUS. & COM. CODE ANN. §§ 6.101-.111, *repealed by* 1993 Tex. Gen. Laws 2098, 2145.

157. TEX. BUS. & COM. CODE ANN. § 6.102(b), *repealed by* 1993 Tex. Gen. Laws 2098, 2145.

158. TEX. BUS. & COM. CODE ANN. § 6.107, *repealed by* 1993 Tex. Gen Laws 2098, 2145.

159. *Id.* § 6.111.

160. *See* discussion *supra* pp. 619-20.

E. De Facto *Merger Does Not Endanger Purchasers in Good Faith*

The principle objection to *de facto* merger is that it seeks to hold one corporation liable for damages caused by another corporation.[161] Public policy recognizes the need to protect innocent parties who purchase assets for reasonable value in good faith that the assets actually belong to the seller and are not subject to prior claims. BFPs are clearly a class the law should and does protect.[162] Therefore, any statutory or common law remedy against transferees must avoid unnecessary imposition of unexpected liabilities on BFPs which deprive them of the benefit of their bargain.

However, public policy requires that BFPs prove good faith.[163] Where insiders of the purchaser are in close relationship with insiders of the seller, as is always the case in a *de facto* merger, good faith is always called into question. If 5.10(B) absolutely precludes proof of *de facto* merger, it relieves a successor from the burden of proving good faith. Furthermore, since notions such as good faith suggest inquiry into a natural person's state of mind, they cannot be easily applied to the fictional corporate person. Examining good faith in sale of asset transactions, therefore, necessarily involves consideration of the relationship of the corporate officers, directors, and shareholders to the assets, both before and after a transfer. Where the officers, shareholders, and directors of the selling corporation retain a substantial interest in the assets after the transfer, then there is a legitimate question as to the BFP status of the purchasing corporation. Has the real person in interest detrimentally changed his position in reliance on the transaction?[164] If the real person in interest, through the magic of corporate formalities, merely stripped the assets from the liabilities formerly attached to them, it cannot be said that this person detrimentally changed his position with respect to those assets. The person has obviously beneficially changed his position with respect to those assets.

At this point, it is helpful to look at the available defenses BFPs have under the statutes mentioned in the comments to 5.10 B which expressly allow imposition of liability on transferees. Under fraudulent transfer law, creditors can obtain various forms of relief against transferees.[165] A transferee, however, may avoid these remedies if the

161. Castilla v. Trinity Indus., 626 S.W.2d 798, 802 (Tex. App.—San Antonio 1981, writ dism'd) (rule of strict liability for injuries from defective products should not be imposed on a party which neither designed, manufactured, nor sold the offending instrumentality nor had the power to prevent its entry into the stream of commerce).

162. *See* J.C. Equip., Inc. v. Sky Aviation, Inc., 498 S.W.2d 73, 76 (Mo. Ct. App. 1973); Lincoln Nat'l Life Ins. Co. v. Brown Schs., 757 S.W.2d 411, 415 (Tex. App.—Houston [14th Dist.] 1988, no writ).

163. *J.C. Equip.*, 498 S.W.2d at 76.

164. *Lincoln Nat'l Life Ins. Co.*, 757 S.W. 2d at 414 ("[T]he doctrine of bona fide purchaser is grounded on an assumption of change of position.").

165. These remedies are:

assets are taken in good faith and for fair value.[166] In other words, if a transferee is a BFP, he will not be held liable. In addition, a transferee may recover the value of any improvements he makes to any goods transferred.[167]

One objection to *de facto* merger is similar to the principle objection to the former bulk transfer law: it creates delay and red tape for legitimate transactions, and presents the possibility of a trap for unwary buyers.[168] However, to minimize the risk of such traps and delays, the subject transactions should be identified as clearly as possible and limited to those which carry dangers to be guarded against.[169] Under bulk transfer law, sanctions were such as to permit honest and solvent buyers and sellers to provide for prompt transactions and without undue risk.[170] Further, bulk transfer law limited actions and levies on transferred goods to those made within six months of a transfer.[171] If a transaction was concealed from creditors, any action by creditors had to be brought within six months after discovery.[172] Similar tailoring could be statutorily applied to relief under the *de facto* merger doctrine without eliminating it altogether.

F. De Facto *Merger Balances the Rights and Needs of Sellers, Creditors, and BFPs*

The greatest protection a BFP has in application of *de facto* merger is that the doctrine never applies to BFPs. BFPs are not affected by *de facto* merger since, under proper application of the doctrine, an arms length purchase of assets with no continuation of relationship between the insiders of the two corporations is not a *de facto* merger.[173]

Moreover, insiders of a transferee who are affected by the doctrine will by definition have an ongoing relationship with insiders of the transferor by virtue of their mutual control over the transferee corpo-

1) avoid the transfer to the extent necessary to satisfy the creditor's claims; 2) obtain an attachment or other provisional remedy against the asset transferred; 3) obtain an injunction against any further transfer by the transferee; 4) obtain the appointment of a receiver to take charge of the asset transferred or other property of the transferee; and 5) levy execution of a judgment on the assets transferred. TEX. BUS. & COM. CODE ANN. § 24.008 (West 1987).

166. TEX. BUS. & COM. CODE ANN. § 24.009 (West 1987 & Supp. 1996).

167. *Id.*

168. TEX. BUS. & COM. CODE ANN. § 6.101 cmt. 5, *repealed by* 1993 Tex. Gen. Laws 2098, 2145.

169. TEX. BUS. & COM. CODE ANN. §§ 6.102-.103, *repealed by* 1993 Tex. Gen. Laws 2098, 2145.

170. TEX. BUS. & COM. CODE ANN. §§ 6.104-.108, *repealed by* 1993 Tex. Gen. Laws 2098, 2145.

171. TEX. BUS. & COM. CODE ANN. § 6.111, *repealed by* 1993 Tex. Gen. Laws 2098, 2145.

172. *Id.*

173. Western Resources Life Ins. Co. v. Gerhardt, 553 S.W.2d 783, 786-87 (Tex. Civ. App.—Austin 1977, writ ref'd n.r.e.).

ration. This ongoing relationship puts insiders in a position to create effective contractual protection for themselves. However, contingent creditors are far less likely to have an ongoing relationship with transferees. Their position is weaker than that of the insiders of the transferee for simple reason: they have no opportunity to create contractual protection during the transaction's negotiation. Public policy favors protecting those who have less opportunity to protect themselves.[174]

De facto merger contains creditor protections similar to those previously provided by bulk transfer law. Further, Article 5.10(B)'s sponsors promised that bulk transfer protection would continue to apply.[175] Even so, any promised protection was extremely limited and no longer exists. Allowing *de facto* merger preserves this promise because it applies not only to the transfer of goods and equipment, but also to the broader spectrum of business activities.[176] In addition, both bulk and fraudulent transfer law adequately protected known creditors, but *de facto* merger protects contingent creditors as well.

Furthermore, *de facto* merger does not interfere with the interests of legitimate sellers who have no intent to avoid creditors. If a corporation liquidates and discontinues business after paying what it can toward known debts, then the corporation has provided all that can be reasonably expected within the confines of limited liability principles. Therefore, creditors, including contingent creditors, are forced to accept the results if all corporate assets have been exhausted and there is no continuing business from which to generate additional revenue and assets.

However, this is never the case in a *de facto* merger. By definition, in a *de facto* merger, the original business is continued by another corporation.[177] There must be more than a mere liquidation of assets. The real owners of the assets retain an interest through their continued ownership of stock and participation in the affairs of the transferee.[178] This continuing interest allows insiders of a transferor to continue enjoying the flow of revenue from the enterprise. It is therefore fair to ask these insiders to pay contingent liabilities out of future revenues generated from the continuing enterprise.

Furthermore, contingent creditors, typically judgment creditors who meet the burden of proof for their claim, may or may not receive more than would have been received if the transaction was deemed a *de facto* merger.[179] Absent a merger, judgment creditors could levy the assets of the would-be seller. Therefore, there is no windfall to

174. *Lincoln Nat'l Life Ins. Co.*, 757 S.W.2d at 414.
175. *See supra* notes 62-83 and accompanying text.
176. *See* discussion *infra* pp. 623-24.
177. *Gerhardt*, 553 S.W.2d at 786.
178. *Id.*
179. *Id.*

creditors if their claims follow the transaction. However, *de facto* mergers may create deeper pockets for creditors; for example, creditors might recover more than if their recovery was limited to the assets of the selling corporation. However, this small risk of creditor windfall does not outweigh the gross injustice of no recovery. To do otherwise allows sellers to escape liability through the magic of corporate formalities, which can easily be structured for the primary purpose of defeating legitimate claims.

CONCLUSION

The plain language of Article 5.10(B) states no more than the general common law rule that a purchaser of assets does not become liable for the debts of the seller.[180] The extra-textual evidence clearly suggests the Texas Legislature passed Article 5.10(B) in an overabundance of caution to clarify the intent of article 5.10(A).[181] The *de facto* merger doctrine, properly applied, should never apply to a mere sale of assets under Article 5.10(A) of the Texas Business Corporations Act. Evidence demonstrates this was accomplished under the mistaken belief that *Gerhardt* held a transaction under article 5.10(A) was a *de facto* merger.[182]

Based on the Bar Committee Comments accompanying the statute, courts and commentators interpreting 5.10(B) have exceeded legislative intent. Under these flawed interpretations, contingent creditors are now deprived of their right to recover judgments from corporate assets. Additionally, statutes such as the Fraudulent Transfer Act are clearly inadequate to protect contingent creditor rights. *De facto* merger, however, balances the rights of sellers, creditors, and BFPs. Under the *de facto* merger doctrine, contingent creditors obtain no windfall; they simply retain the right to seek relief from corporate assets, as they would have had the merger not occurred.

Further, BFPs should never be subject to application of the *de facto* merger doctrine. *De facto* merger does not apply unless a BFP has a continuing relationship with a seller who has become part of the BFP's corporation. This is logical since both sellers and BFPs are in a better position to foresee and insure against contingent liabilities than are contingent creditors.

Given these considerations, the Texas Legislature should codify a *de facto* merger statute. This statute should set forth the elements from *Gerhardt* required to determine a transaction a *de facto* merger.[183] Further, the statute should include elements of bulk transfer law to

180. *Id.*
181. *See* discussion *infra* pp. 602-09.
182. *Tape of Senate Subcomm. on Civil Matters*, *supra* note 60.
183. Western Resources Life Ins. Co. v. Gerhardt, 553 S.W.2d 783, 786 (Tex. Civ. App.—Austin 1977, writ ref'd n.r.e.).

minimize delays and red tape for legitimate transactions.[184] Only by accomplishing this can creditors, transferors, and transferees be protected.

Frank William McIntyre

184. *See supra* notes 168-172 and accompanying text.