Fraud Is Now Legal in Texas (For Some People)

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ARTICLES

FRAUD IS NOW LEGAL IN TEXAS
(FOR SOME PEOPLE)

by: Val Ricks*

ABSTRACT

Three intermediate appellate courts in Texas have held that corporate actors—directors, officers, managers, shareholders, and probably common employees and agents—are immune from personal liability for fraud that they themselves commit as long as their deceit relates to or arises from a contractual obligation of the corporation. Similar actors in limited liability companies also enjoy immunity. These courts do not require that the business entities themselves be liable for the fraud. When the entities are not liable, these new holdings leave fraud victims no remedy at all, even if a jury would find fraud. One (or maybe two) Texas appellate courts have held otherwise. The Supreme Court of Texas will probably decide the issue, and one justice has already signed on.

To date, these decisions have only been noticed in print by a few practicing attorneys. No commentator has questioned them. But the decisions are wrong. These courts claim to be following a statute, but the statute does not support the courts’ analysis. Nor does the statute’s legislative history. Surprising (and probably unnoticed) results strongly suggest the legislature never intended this reading. And what rationale could justify it? Fraud is the economic equivalent of theft. Practitioner comments on the decisions suggest that the cost of litigating fraud is too high. Texas’s reputation for pro-business policies might suggest this move is just helpful de-regulation, but it is not. Policing fraud is the only way to make markets safe for freedom of contract, and litigating fraud claims is the courts’ role. These decisions should be abandoned before they become the law in all of Texas and elsewhere.

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I. Introduction

Two recent appellate cases in Houston and one in El Paso (and an older one in Texarkana) have held that corporate actors—directors, officers, managers, shareholders, and probably common employees and agents—are immune from personal liability for the fraud and misrepresentation these actors commit as long as the deceit relates to or arises from a contractual obligation of the corporation.1 Similar actors in limited liability companies also enjoy immunity. Courts do not require that the companies themselves be liable for such fraud. When the company is not liable, the law leaves fraud victims no remedy at all.

In each of these cases, the claim against the corporate actor has been brought by someone to whom the corporation owes money. The

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corporation’s contract counterparty has sued the corporation but also sued the corporate actor for fraud. The personal claim may be motivated by vendetta, leverage, or justice and a hope of recovery, but usually the corporate actor and her attorney believe the corporate actor should not be sued individually for something she did as part of her job. As nearly as I can tell (see Part V), and based on endorsements from practicing attorneys, the courts’ reading of the statute is an attempt to support the understanding of the corporate actor’s lawyer.

These courts claim to be following a statute (set out in Part II) that on its face addresses veil-piercing. The courts claim that the legislature slipped some language in without fanfare or announcement (or even suggestion) in 1997 that actually creates a broad immunity from liability for fraud connected to a contract in any way by anyone in the named group of business actors. No court seemed to notice this provision until 2001 (the Texarkana case), and after that not until 2017, when a Houston intermediate appellate court decided to adopt this immunity in a case in which it had not been argued by counsel. I describe the Houston cases in detail in Part III. They were decided by the 14th Court of Appeals, called affectionately here “the 14th.” The 14th’s opinions are the most cogent defense of this new position—this reading of the statute. Now the El Paso appellate court has decided to follow the 14th. The court of appeals in Corpus Christi (and perhaps the one in San Antonio) has declined to follow. The Supreme Court of Texas will probably decide the issue. One judge who signed on in the 14th now sits on the Supreme Court of Texas (Busby). Perhaps this theory will cover all of Texas.

2. Except in the El Paso case in which only the individual was sued. See Sifuentes, 595 S.W.3d at 871.
4. Nothing in the bill analysis of the 1997 amendments mentions anything like this. See House Comm. on Bus. & Indus., Bill Analysis, Tex. S.B. 555, 75th Leg., R.S. (1997). The introduced, Senate, and House bill analyses are all equally bland and empty in this respect. All are available at Texas Legislature Online.
5. See Sifuentes, 595 S.W.3d at 877–78; Havey, 551 S.W.3d at 883; TecLogistics, 527 S.W.3d at 599–600.
6. See Mecom, 28 S.W.3d at 136–38.
7. See TecLogistics, 527 S.W.3d at 603. The Houston opinions do not mention Mecom, 28 S.W.3d at 129, the case from Texarkana.
For now, however, Houston is a large commercial jurisdiction, and these decisions exempt quite a lot of fraud from liability. If the theory spreads across the state, quite a lot more fraud will be exempt.

The cases are troubling for several reasons. First, the statute does not support the courts’ reading. Parts III (describing the cases) and IV.A show how the courts have misread the statute. The statute’s plain language limits it to veil-piercing claims. The courts have picked out from the statute the language they are applying and disregarded the rest. The courts have also read into the legislative history an intent that is not there.

The courts also have failed to consider several disturbing and certainly unintended results of this reading of the statute. For instance, the courts’ reading of the statute enables fraud and sometimes makes fraud pay, as Part IV.B and Part IV.C.2 show. How could it not pay, for the individual tortfeasor? She has literally gotten away with fraud. Part IV.C lists additional results. For instance,

- the statute limits personal liability for fraud but not for the far less serious offense of negligence;
- if the statute limits the liability of these corporate actors for fraud against corporate obligees, the statute also limits the personal liability of these same corporate actors for frauds they commit against the corporation itself—against their own employers;
- if an employee or agent commits fraud and renders the employer liable vicariously, the employer is unable under the 14th’s reading to seek indemnity from the employee;
- immunity from personal liability for fraud becomes under this theory purchasable for the price of a share of stock; and
- the reading of the statute oddly grants to corporate and LLC actors an immunity not available to any other business person, no matter what other kind of business or business entity they may work with.

Both the individual and cumulative effects of these results persuade that the Texas Legislature intended no such result. No such result comes from this statute’s language.

The Texas courts already do not follow the veil-piercing statutes as they are written.10 Their results mock these statutes and make it im-

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10. See generally Val Ricks, The Twisted Veil of Texas LLCs, 46 TEX. J. BUS. LAW 67 (2014). Section 101.002(a) of the Texas Business Organizations Code states that the corporate veil-piercing statutes are applicable to limited liability companies “[s]ubject to Section 101.114,” and Section 101.114’s only language limits a member or manager’s liability for entity obligations. To be subject to Section 101.114 means veil-piercing is not allowed. Moreover, Section 101.113 prohibits a lawsuit in which both the LLC and a member are parties, unless “the action is brought to enforce the member’s right against or liability to the company.” TEX. BUS. ORGS. CODE ANN. § 101.113 (West 2019). Virtually all veil-piercing suits involving LLCs make the LLC
possible for lawyers to know from the code what courts will do. This latest reading of the corporate code has a similar effect, and in addition overturns—alone, as no other state does this—fundamental rules of tort and agency law upon which trust necessary for business activities and freedom of contract thrive. According to comments from practicing attorneys, these courts have decided to stop policing fraud in favor of cutting back on litigation. Policing fraud is hard, and sometimes it is expensive, but if the courts are unwilling to do the hard work, the cost of doing business in Texas will increase, and this will harm Texas, its people, and those who do business with them. Part V addresses possible policy justifications for the recent reading of the statute, and not surprisingly finds nothing very persuasive. Fraud is theft, and protecting against it is vital to the protection of property rights and the trust necessary for freedom of contract.

The literature has not yet taken notice of these decisions or of this kind of development, which appears to be a unique experiment.

II. **THE STATUTE**

The statute which the 14th claims creates a personal business fraud exemption reads in relevant part as follows:

(a) A holder of shares, an owner of any beneficial interest in shares, . . . or any affiliate of such a holder [or] owner . . . may not be held liable to the corporation or its obligees with respect to: . . .

(2) any contractual obligation of the corporation or any matter relating to or arising from the obligation on the basis that the holder, beneficial owner, . . . or affiliate is or was the alter ego of the corporation or on the basis of actual or constructive fraud, a sham to perpetrate a fraud, or other similar theory; or

(3) any obligation of the corporation on the basis of the failure of the corporation to observe any corporate formality, including the failure to:

(A) comply with this code or the certificate of formation or bylaws of the corporation; or

(B) observe any requirement prescribed by this code or the certificate of formation or bylaws of the corporation for acts to be taken by the corporation or its directors or shareholders.

(b) Subsection (a)(2) does not prevent or limit the liability of a holder, beneficial owner, . . . or affiliate if the obligee demonstrates that the holder, beneficial owner, . . . or affiliate caused the corporation to be used for the purpose of perpetrating and did perpetrate an actual fraud on the obligee primarily for the direct personal benefit of the holder, beneficial owner, . . . or affiliate.

The statute follows up with Section 21.224, which holds,

and member party defendants, the very thing the code prohibits. See Ricks, supra note 10, at 72–74.

11. See generally Ricks, supra note 10 and accompanying text.

The liability of a holder, beneficial owner, . . . or any affiliate of such a holder, owner, . . . or of the corporation for an obligation that is limited by Section 21.223 is exclusive and preempts any other liability imposed for that obligation under common law or otherwise.13

Section 21.225 clarifies that Sections 21.223 and 21.224 do not affect liability expressly assumed or imposed by some other statute.14 Affiliate is a defined term; it “means a person who controls, is controlled by, or is under common control with another person.”15 Affiliate appears to include managers of many closely held business entities. It probably also includes agents of business entities, as these are subject to the entity’s control.

The courts and commentators have been quite clear that the intent of this statute was to reverse the effect of Castleberry v. Branscum,16 a veil-piercing decision that many lawyers thought set forth loose standards, opening shareholders to too great a threat of liability.17 The original statutory response was drafted “to eliminate constructive fraud as a basis for holding shareholders liable for contractual obligations of a corporation.”18 The statute was not entirely successful, and the statute was amended in 1993 and 1997 to shore up the protection.19 The 1993 amendment added the exclusivity language of Section 21.224.20 The 1997 amendment added “any affiliate” and broadened the language now found in Section 21.223(a)(2) to include “any matter relating to or arising from” a contractual obligation.21 The statute was adopted from the Texas Business Corporations Act without significant language change into the Texas Business Organizations Code (“TBOC”) when the TBOC was passed in 2003.22

A separate legislative act supposedly applies this statute to LLCs.23 The applicability of the veil-piercing doctrine to LLCs in Texas is any-

13. Id. § 21.224.
15. Id. § 1.002(1).
19. See Miller & Ragazzo, supra note 17, § 463.
20. See infra Part IV.A.4, which includes the bill language from the 1997 amendment.
21. Id.
thing but clear if the LLC statutes mean anything at all,24 but if veil piercing against an LLC member or manager is possible, it probably would have to proceed on the same principles as it would against a corporate shareholder or manager.25

The personal business fraud exemption rests, according to the 14th, on certain language of the statute, specifically this language:

(a) A holder of shares . . . , or any affiliate of such a holder . . . or of the corporation, may not be held liable to . . . [the corporation’s] obligees with respect to . . .

(2) any contractual obligation of the corporation or any matter relating to or arising from the obligation . . . on the basis of actual or constructive fraud . . . .26

This language and Section 21.224’s proclamation of exclusivity provide a limit for shareholders and affiliates—that is the 14th’s claim, anyway. Section 101.002 of the TBOC instructs us, when dealing with an LLC, to insert LLC terms in place of the corporation terms.27 If we do, the applicable law would read as follows:

(a) A member or any affiliate of such a member or of the limited liability company may not be held liable to the limited liability company’s obligees with respect to . . .

(2) any contractual obligation of the limited liability company or any matter relating to or arising from the obligation . . . on the basis of actual or constructive fraud . . . .28

This language appears to have the effect claimed by the 14th. So long as the fraud arises from or relates to a contractual obligation of the business,29 the shareholder, member, or affiliate will not be liable for it to an obligee of the entity on the basis of actual or constructive

26. Id. § 21.223(a).
27. Id. § 101.002.
28. Id. § 21.223 through the lens of § 101.002. The translation is not literal. Subsection (a) of 21.223 refers to a “holder of shares, an owner of any beneficial interest in shares.” Section 101.002 says, literally, that “[f]or purposes of the application of Subsection (a): (1) a reference to shares includes ‘membership interests’; (2) a reference to ‘holder,’ ‘owner,’ or ‘shareholder’ includes a ‘member’ . . . ; (3) a reference to ‘corporation’ or ‘corporate’ includes a ‘limited liability company’ . . . .” Id. § 101.002(b). Applied literally, Section 101.002(b) requires that Section 21.223(a) read, “A member of membership interests, a member of any beneficial interest in membership interests,” and so on, which makes no sense at all. But the intent of Section 101.002 is perhaps clear enough that Sections “21.223 [and] 21.224 . . . apply to a limited liability company and the company’s members, owners, . . . affiliates.” Sense at least can be made of this, and I have tried to do so in the text.
fraud—that is the court’s claim. If subsection (a) applies, then a court also has to examine whether subsection (b) applies to allow liability. If the statute is read to apply this way, then the 14th claims that Section 21.224 says that there is no other way to make the shareholder or member liable. Thus, the court says, it is following the statute’s “plain language.”

The court is mistaken. The 14th’s reading of the statute is incorrect for a number of reasons introduced in Part III and fully discussed in Part IV. Part III examines the two cases in which the 14th has applied the statute in this way. The discussion shows the effect of this reading, which has been used twice now to avoid jury verdicts in favor of fraud victims and quite literally let business people get away with fraud. After Part III’s illustration, Part IV will explain further how the 14th’s theory goes astray.

III. THE HOUSTON CASES

A. TecLogistics

The 14th first adopted this reading in *TecLogistics, Inc. v. Dresser-Rand Group, Inc.* The case involved fraud in the performance of a contract.

Dresser-Rand employed TecLogistics to send items to and from Dresser-Rand’s customers. TecLogistics “commonly subcontracted its work to Pentagon Freight Services,” however. TecLogistics would then submit a subcontractor invoice to Dresser-Rand: Dresser-Rand “required TecLogistics to ‘back up’ the charges by submitting Pentagon’s invoices” with its own. Dresser-Rand paid the “passed-through charges.” TecLogistics’s president Josephine Treurniet created fake Pentagon invoices with higher-than-actual charges, then submitted them to Dresser-Rand to justify overcharging for TecLogistics’s services. Dresser-Rand paid the padded bills.

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32. *Id.* at 592.

33. *Id.*

34. *Id.*

35. *Id.*

36. *Id.* at 594.

37. *Id.*
Dresser-Rand sued both TecLogistics and Treurniet for common law fraud. Treurniet “admitted at trial . . . that she had created the false Pentagon invoices to back up” the overcharges. A jury found that TecLogistics had committed fraud on these facts, a conclusion that the court of appeals affirmed. Treurniet was, by her own admission, the only human agent to act for TecLogistics with regard to the fraud. Treurniet committed common law fraud. But the trial court refused to let the jury hear the fraud claim against Treurniet and ordered that Dresser-Rand “take nothing” from Treurniet, meaning that Treurniet was not liable for fraud. The court of appeals affirmed on the basis that the statute barred the claim.

There is nothing remarkable about the court’s reasoning. In the following columns, we can see how the court matched up the facts to the statute’s language:

38. Id. at 592. Dresser-Rand obtained copies of Pentagon’s actual invoices. Id.
39. Id.
40. Id. at 592–93, 594–95, 598. The court explained, Dresser-Rand alleged actual fraud. This allegation also was supported by the evidence: Treurniet knew what Pentagon actually charged, but she admittedly created the false Pentagon invoices, and she personally signed the TecLogistics’ invoices incorporating the knowing misrepresentations. She admits that no one else at TecLogistics was involved in creating and tendering the invoices. Treurniet, then, was the human agent through which TecLogistics committed actual fraud against Dresser-Rand.

41. Id. at 596, 594.
42. In a separate place, the court of appeals admitted that Dresser-Rand’s fraud allegation against Treurniet was supported by the evidence: Treurniet knew what Pentagon actually charged, but she admittedly created the false Pentagon invoices, and she personally signed the TecLogistics’ invoices incorporating the knowing misrepresentations. She admits that no one else at TecLogistics was involved in creating and tendering the invoices. Treurniet, then, was the human agent through which TecLogistics committed actual fraud against Dresser-Rand.

43. Id. at 598.
45. TecLogistics, 527 S.W.3d at 598.
(a) A holder of shares . . . or any affiliate of such a holder . . . or of the corporation, TecLogistics “is a corporation.”46  
Treurniet “is TecLogistics’ owner and president”; both parties referred to her as “owner” or having an “ownership interest.”47 This made her both shareholder and affiliate.48

may not be held liable to . . . [the corporation’s] obligees Dresser-Rand was an obligee of TecLogistics; TecLogistics owed it services pursuant to contract.49

with respect to . . . (2) any contractual obligation of the corporation or any matter relating to or arising from the obligation . . . TecLogistics was obliged by contract to “provide documentation” supporting its charges.50

on the basis that the holder . . . or affiliate is or was the alter ego of the corporation or on the basis of actual or constructive fraud, a sham to perpetrate a fraud, or other similar theory . . . . The claim against Treurniet was actual fraud, and the evidence clearly supported the claim.52

I have simplified the last element so that you see what the court did. The court’s analysis of the last element is less clear than these columns make it, however. This part of the statute—“on the basis . . .”—is in fact clearly contrary to the court’s analysis, yet the court treats it as plainly precluding a shareholder’s liability. This is where the court’s analysis goes most obviously astray. The clause in its entirety (and to the court’s credit, it quotes the whole clause) contains a list of theo-

46. TEX. BUS. ORGS. CODE ANN. § 21.223(a) (West 2019).
47. TecLogistics, 527 S.W.3d at 597.
48. Id.
49. Id.
50. Id. at 598.
51. Id. The court adds more words but no additional substance in a long passage: This required connection between individual liability and corporate contractual obligation, too, is satisfied. TecLogistics’ contractual obligations to Dresser-Rand were not only to forward freight to and from Dresser-Rand’s customers, but also to provide documentation to Dresser-Rand to support its charges. As Hart explained, Dresser-Rand requires documentation to support a freight-forwarder’s invoice because the company typically passes freight-forwarding charges through to the customer, and Dresser-Rand “has[s] to provide invoice and documentation when we bill the client showing what those charges are.” To ensure the accuracy of those charges, a freight-forwarder’s invoice and its supporting documentation is first reviewed by Dresser-Rand’s accounts-payable department to see that they match. The same review is repeated by those responsible for supply-chain management. Dresser-Rand additionally conducts internal audits to ensure that the documentation is in order.

Id. at 597–98.
52. Id. at 598.
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ries: “on the basis that the holder . . . is or was the alter ego of the corporation or on the basis of actual or constructive fraud, a sham to perpetrate a fraud, or other similar theory.”53 The theories are theories of veil piercing, and all were mentioned in Castleberry.54 Veil piercing is a theory of “derivative liability”55 because it imposes on shareholders and other corporate controllers the liability of the corporation; their liability is derived from the corporation’s liability. Because “alter ego” is also a theory of derivative liability and also was mentioned in Castleberry,56 the most natural reading of “other similar theory” in the statute is that it includes “alter ego.”57 But even if only the theories in the second “on the basis” clause are referred to by the words “other similar,” all of these are veil-piercing theories— theories of derivative liability. The theories remain current today as veil-piercing theories.58 Veil-piercing theories are what the statute names.59

Treurniet was charged with the tort of “actual fraud,” but not the veil-piercing theory.60 The veil-piercing theory and the tort have the same name and concern with intentional deception, but that is all. The

54. See Castleberry v. Branscum, 721 S.W.2d 270, 272–73 (Tex. 1986); see also Rose v. Intercontinental Bank, N.A., 705 S.W.2d 752, 756 (Tex. App.—Houston [1st Dist.] 1986, writ ref’d n.r.e.) (“Basing a claim of alter ego on fraudulent intent is only one manner to establish the claim.”); Tigrett v. Pointer, 580 S.W.2d 375, 385 (Tex. App.—Dallas 1978, writ ref’d, n.r.e.) (describing alter ego, fraud, and constructive fraud). Castleberry defined actual fraud but did not name a veil-piercing theory that required it; Castleberry held that constructive fraud was sufficient even without showing actual fraud. 721 S.W.2d at 273. It is implausible, however, that Castleberry meant to allow veil-piercing for constructive fraud but not for actual fraud, a more culpable act. Castleberry’s naming “fraud” as a ground for veil-piercing clearly intended to include both.

55. The phrase comes from Willis v. Donnelly, 199 S.W.3d 262, 273 (Tex. 2006).
56. See Castleberry, 721 S.W.2d at 272.
57. See Willis, 199 S.W.3d at 273 (“We hold that characterizing the theory as ‘ratification’ rather than ‘alter ego’ is simply asserting a ‘similar theory’ of derivative liability that is covered by the statute.”); Castleberry, 721 S.W.2d at 272 (“[A]lter ego is only one of the bases for disregarding the corporate fiction.” “The basis used here to disregard the corporate fiction . . . is separate from alter ego.”); id. at 278 (Gonzalez, J., dissenting) (“Castleberry . . . had to produce some evidence either under an alter ego theory or under a use of the corporate entity as a sham to perpetrate a fraud theory.”); Lucas v. Texas Indus., 696 S.W.2d 372, 374–75 (Tex. 1984) (employing “alter ego” as a general name for all veil-piercing or derivative shareholder liability theories). On this, Glenn West agrees. See Glenn D. West & Susan Y. Chao, Corporations, 56 S.M.U. L. REV. 1395, 1407 (2003) (“The phrase ‘or other similar theory’ does not relate only to alter ego—a piercing the corporate veil theory—but to ‘actual fraud,’ ‘constructive fraud,’ and ‘a sham to perpetrate a fraud.’”).
60. At least, only claims for fraud and (against TecLogistics) breach of contract remained at the time of trial. See TecLogistics, Inc. v. Dresser-Rand Grp., Inc., 527 S.W.3d 589, 596–97 (Tex. App.—Houston [14th Dist.] 2017, no pet.).
veil-piercing claim is established by showing that “the corporate form has been used as part of a basically unfair device to achieve an inequitable result,”61 and one way to show unfairness or inequity is by what Castleberry called actual fraud: “dishonesty of purpose or intent to deceive.”62 Courts agreed that this kind of misuse of the corporate form would warrant piercing the corporate veil,63 and courts since have mostly agreed that the veil-piercing theory named in Section 21.223(a)(2) does not require a showing of the elements of the tort (which would make veil-piercing largely beside the point); nor does subsection (b), which preserves actual fraud as a ground for veil-piercing, require a showing of the elements of the common law tort of fraud.64 Unlike the veil-piercing theory, the tort of course requires that the five elements of the tort of actual fraud be proved.65 The TecLogistics court in effect conflated these two theories, claiming that

62. Castleberry, 721 S.W.2d at 273 (quoting Archer v. Griffith, 390 S.W.2d 735, 740 (Tex. 1964)).
63. See supra note 54.
65. Anderson v. Durant, 550 S.W.3d 605, 614 (Tex. 2018) (“Fraudulent inducement is a species of common-law fraud that shares the same basic elements: (1) a material misrepresentation, (2) made with knowledge of its falsity or asserted without knowledge of its truth, (3) made with the intention that it should be acted on by the other party, (4) which the other party relied on and (5) which caused injury.”).
Treurniet's liability was “based on” one when it was actually based on the other. Treurniet was charged with the common law tort of fraud.

The person who drafted the court’s analysis seems to know the difference between the two theories but tried to paper over the difference nonetheless. Notwithstanding that the case against Treurniet was brought for common law fraud, when the court tried to define “actual fraud,” it ignored the elements of the tort and used instead the language that Castleberry used to describe the veil-piercing theory: “usually involves dishonesty of purpose or intent to deceive.”66 The court then analyzed whether Dresser-Rand alleged that Treurniet had done this. Of course, the complaint did make such an allegation, because conduct involving intent to deceive describes some—but not all—of the elements of the common law tort of fraud.67

But the basis of Treurniet’s liability was not merely that she engaged in conduct that involved “dishonesty of purpose or intent to deceive.” The conduct described by this phrase is not itself tortious. No common law fraud liability exists for a dishonest intention. Treurniet could not have been found personally liable for anything on the basis the court named unless it was a reference to a more complete theory. What the court named is a partial description of a veil-piercing theory.

The actual basis of Treurniet’s liability was that she had committed a tort—that she had committed all the elements of the common law tort of fraud. The tort has five elements, all of which must be proved.68 That tort is neither referred to nor included in the veil-piercing theory the court named.

The common law tort of fraud is simply not an “other similar theory” to the theories of veil-piercing listed in Section 21.223(a)(2). It is not a theory of veil-piercing at all. The court failed to read “actual . . . fraud” in light of “other similar theory.” In this respect, the court ignored the plain meaning of the statute. The court also conflated for purposes of the phrase “on the basis of” (i) “actual . . . fraud” the veil-piercing theory and (ii) the tort of actual fraud.

Of course, Dresser-Rand objected that Treurniet was liable under the common law tort of fraud. In response, the court cited Section 21.224, which provides that “liability . . . ‘for an obligation that is limited by Section 21.223 is exclusive and preempts any other liability imposed for that obligation under common law or otherwise.’”69 Section 21.224 as written depends entirely on what “is limited by Section

67. See Anderson, 550 S.W.3d at 614.
68. See id.
69. TecLogistics, 527 S.W.3d at 598–99 (quoting TEX. BUS. ORGS. CODE ANN. § 21.224 (West)). The court did not explain why Section 21.224 was needed; Section 21.223 is a statute, too, and all statutes control over the common law.
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21.223,” however. What Section 21.223 limits is, as shown, only “liability . . . on the basis” of a veil-piercing theory. Thus, in Section 21.224, the only “liability . . . for an obligation that is limited by Section 21.223” is liability for a corporate obligation under a veil-piercing theory.70 If Section 21.223 actually applied to Treurniet’s liability, both Sections 21.223 and 21.224 might have barred it. But Section 21.223 does not limit personal liability on the basis of tort law for the torts one commits, so the obligation to pay a remedy for the torts one commits—which has an entirely different basis than the liability addressed by Section 21.223—is not limited or preempted by either Section 21.223 or Section 21.224. The language of Section 21.224 has not been literally applied (and is somewhat mysterious),71 but given Section

70. Section 21.224 equates 21.223’s “liability” with “an obligation.” Section 21.224’s phrase is “liability . . . for an obligation that is limited by Section 21.223”: “The liability of a holder . . . or any affiliate . . . for an obligation that is limited by Section 21.223 is exclusive and preempts any other liability imposed for that obligation under the common law or otherwise.” TEX. BUS. ORGS. CODE ANN. § 21.224 (West). However, the only “obligation” addressed by Section 21.223 is a “contractual obligation of the corporation” in (a)(2) and an “obligation of the corporation” in (a)(3). Nothing in Section 21.223 limits these obligation(s). Section 21.223 instead limits liability: “may not be held liable . . . with respect to . . . any contractual obligation of the corporation . . . or any obligation of the corporation . . . .” The switch in Section 21.224 is confusing, but the language of Section 21.224 makes sense if a liability limited in Section 21.223 becomes in Section 21.224 “an obligation that is limited by Section 21.223” or, perhaps better and more true to Section 21.224’s language, “liability-for-an-obligation that is limited by Section 21.223,” as Section 21.223 limits only derivative liability.

71. Besides the conflation of “liability” and “obligation” mentioned previously, see supra note 70, Section 21.224 pretends to preempt something that Section 21.223 itself does not disturb, and courts have never read it literally. Section 21.224 says, “The liability of a holder . . . or . . . affiliate . . . for an obligation that is limited by Section 21.223 is exclusive.” Meaning what? The shareholder is exclusively liable for such things? That is unlikely; Section 21.223 does not purport to limit the corporation’s liability for its own obligations, and no court has held this. So Section 21.224’s exclusivity claim is not literally true as applied and probably was not intended.

Perhaps Section 21.224 means to say that Section 21.223’s method of reaching the shareholder or other corporate actor for a corporate obligation is exclusive. Saying that Section 21.223 is the exclusive way of reaching shareholders for this purpose is an imaginative reconstruction consistent with Section 21.223’s purpose. That reconstruction is also consistent with the rest of Section 21.224, which claims, “The liability of a [shareholder or affiliate] . . . for an obligation that is limited by Section 21.223 . . . preempts any other liability imposed for that obligation under the common law or otherwise.” However, that reconstruction has also never been true in fact. Section 21.223 does not set out a way to reach a shareholder; it is merely negative—it only imposes some limitations on methods already existing. Saying that merely negative language is “exclusive and preempts any other liability” does not even make logical sense. Section 21.223 as written does not even pretend to preempt all common law in the area, and Section 21.224 cannot make Section 21.223 do something it clearly cannot do. For instance, Section (a)(2) does not purport to touch veil-piercing liability for tort obligations, and (a)(3) does not disrupt that liability much, only forbidding the use of “corporate formalities” in the court’s analysis. TEX. BUS. ORGS. CODE ANN. § 21.223(a)(2)–(3) (West). Section 21.223 otherwise leaves common law or equitable veil-piercing for tort liability intact, as the courts have recognized and apply. See Durham v. Accardi, 587 S.W.3d 179, 186 (Tex. App.—Houston [14th Dist.] 2019, no pet.)
21.224’s dependence on Section 21.223, any attempt to use Section 21.224 to add content to Section 21.223 is circular, just bootstrapping.

Section 21.225 is likewise limited in effect, and the actual language of Section 21.225 confirms that Sections 21.223 and 21.224 are limited to veil-piercing liability. Section 21.225 is unfortunately titled “Exceptions to Limitations,” reflecting a phrase in the legislation that created it, but its words do not purport to except anything and the

(citing only Castleberry v. Branscum, 721 S.W.2d 270 (Tex. 1986), and other common law for veil-piercing standards; mentioning Section 21.223 only for the proposition that formalities are “no longer a consideration when determining an alter ego question”); Hovel v. Batzri, 490 S.W.3d 132, 146 n.21 (Tex. App.—Houston [1st Dist.] 2016, pet. denied) (“Tort creditors may seek to pierce the corporate veil under the common law.”); MBR & Assocs., Inc. v. Lile, No. 02-11-00431-CV, 2012 WL 4661665, at *5 (Tex. App.—Fort Worth Oct. 4, 2012, pet. denied) (affirming an alter ego claim in a tort liability case on the basis of common law principles alone). Therefore, this reconstruction of Section 21.224 simply cannot be taken as literally true; Section 21.224 does not make Section 21.223 the exclusive means of reaching shareholders even for veil-piercing liability, nor does it preempt the common law, which is still the method of imposing veil-piercing liability for tort even though Section 21.223 limits the way in which the common law works. Courts continue to use the common law theories even in cases of contractual obligation, also, again proving that Section 21.224 has never preempted anything. See, e.g., SSP Partners v. Gladstrong Invs. (USA) Corp., 275 S.W.3d 444, 451 (Tex. 2008) (stating, “[w]e have held that the limitation on liability afforded by the corporate structure can be ignored only ‘when the corporate form has been used as part of a basically unfair device to achieve an inequitable result,’” and citing Castleberry, 721 S.W.2d 270, even though this standard is absent from Section 21.223, as SSP Partners, 275 S.W.3d 444, also discussed); Chico Auto Parts & Serv., Inc. v. Crockett, 512 S.W.3d 560, 573 (Tex. App.—El Paso 2017, pet. denied) (rejecting a veil-piercing claim for contract-based liability on the grounds that the plaintiff had shown no evidence of alter ego).

Fortunately, another construction of Section 21.224 is possible that is consistent with Section 21.224’s language. In normal legal thinking, all statutes preempt the common law, so Section 21.223 can preempt the common law all on its own, without Section 21.224’s help. What Section 21.223 cannot do, perhaps, is overcome courts’ hesitancy to allow defendants to get away with constructive fraud. Courts’ jurisdiction in equity “to prevent absurdity applies when following a statute would require the court to countenance a fraud.” See Ricks, supra note 10, at 69. The courts have applied this jurisdiction to cut back on the Statute of Frauds, statutes of limitation, and others. See id. at 70; e.g., Hooks v. Bridgewater, 229 S.W. 1114, 1116 (Tex. 1921) (“Equity has no concern in such cases except to prevent the perpetration of a fraud.”); Hunt v. Turner, 9 Tex. 385, 385 (1853) (“A contract may be void under the statute of frauds; yet if the conduct of the party setting up the invalidity of the contract has been such as to raise an equity outside of and independent of the contract, and nothing else will be adequate satisfaction of such equity, the sale will be sustained, though not valid under the statute of frauds.”). Section 21.223 may be subject to the same objection as the Statute of Frauds; Section 21.223’s purpose, in fact, was to restrict veil-piercing on grounds of constructive fraud. Section 21.224’s purpose is to tell the courts, “We mean to do this; set equity aside to this extent.” It is Hooks and Hunt and the like—that “common law of equity”—that Section 21.224 means Section 21.223 to preempt and exclude.

72. “The heading of a title, subtitle, chapter, subchapter, or section does not limit or expand the meaning of a statute.” TEX. GOV’T CODE ANN. § 311.024 (West). The Texas Supreme Court characterized the section as creating a “statutory exception.” Willis v. Donnelly, 199 S.W.3d 262, 272 (Tex. 2006).
language of exception is omitted from the TBOC. 73 The Section says merely, “Section 21.223 or 21.224 does not limit the obligation of the holder . . . or affiliate to the obligee of the corporation if that person” contracted for the liability or is liable for it under some other statute. 74 The Code’s language is true, despite its title: Sections 21.223 and 21.224 do not limit any such thing. Because Sections 21.223 and 21.224 do not pretend to have any effect on any liability except derivative liability “on the basis of” a veil-piercing theory, nothing in them could have any effect on the direct contractual liability or other statutory liability of corporate actors. Nothing in Section 21.224 or 21.225 helps the TecLogistics court.

The TecLogistics court thought to shore up its reading with a recitation of the statute’s legislative history. 75 The key amendment, the court said, occurred when the legislature in 1997 added the phrase “any matter relating to or arising from the obligation” and included affiliates. 76 But even though the scope of contractual liability covered by subsection 21.223(a)(2) expanded to cover contract-related liability, the subsection still addresses only liability “on the basis of . . . [alter ego or several other named veil-piercing theories] or other similar theory.” 77 The liability that Section 21.224 preempts is only veil-piercing liability. I address the legislative history in full in Part IV.A.4.

After holding that the statute’s prohibition applied to Dresser-Rand’s common law fraud claim against Treurniet, the court turned to the prohibition’s second part:

Subsection (a)(2) does not prevent or limit the liability of a holder . . . or affiliate if the obligee demonstrates that the holder . . . or affiliate caused the corporation to be used for the purpose of perpe-


76. Id. at 600.

77. TEX. BUS. ORGS. CODE ANN. § 21.223(a)(2) (West 2019).
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trating and did perpetrate an actual fraud on the obligee primarily for the direct personal benefit of the holder . . . or affiliate.\textsuperscript{78}

This language did not apply, the court said, but it made no ruling because Dresser-Rand neither pleaded nor proved that Treurniet “acted primarily for her direct personal benefit.”\textsuperscript{79} The court elaborated on the language a few months later in \textit{Hong v. Havey}.\textsuperscript{80}

\section*{B. \textit{Hong v. Havey}}

Mandy Hong and three relatives were shareholders of Shadow Creek Bay, Inc. (“Shadow”); Hong was the primary manager.\textsuperscript{81} Shadow bought a 6.24-acre tract of land with two bank loans that the shareholders personally guaranteed.\textsuperscript{82} But Shadow fell into financial trouble and became delinquent. “These difficulties prompted efforts to sell the 6.24-acre tract.”\textsuperscript{83} Shadow owed about $1,728,000.\textsuperscript{84} One shareholder testified that the shareholders tried to sell the tract in order to avoid guarantee liability,\textsuperscript{85} and this concern was reflected in Hong’s communication with realtors.\textsuperscript{86}

Shadow worked with a realtor, Fuentes, to sell the property.\textsuperscript{87} While continuing to encourage Fuentes to sell the tract, Hong met with Havey and on Shadow’s behalf executed a contract entitled “Commercial Real Estate Listing Agreement, Exclusive Right to Sell.”\textsuperscript{88} In this contract, Shadow through Hong promised to list the tract exclusively with Havey’s company, United Texas Realtors (“United”).\textsuperscript{89} The agreement obligated Shadow to pay a 4% commission if the tract sold “to anyone at any price on any terms” during the period of the agreement.\textsuperscript{90} The listing agreement with United contemplated marketing the tract for about $1.7 million—what Shadow owed the bank.\textsuperscript{91}

United’s owner, Havey, arranged a sale of the property for $1.4 million, and Shadow signed a sales contract for that.\textsuperscript{92} Despite this contract and the listing agreement, Shadow failed to appear at the
scheduled closing and continued to work with Fuentes.93 Shadow later sold the property to another party through Fuentes for $1.525 million.94 Shadow paid a commission to Fuentes and refused to pay United a commission.95 The sale left Shadow with $200,000 owing to the bank; after negotiations, the bank released its lien “in exchange for a $100,000 note” from Shadow, guaranteed by Hong’s spouse.96 The sale through Fuentes thus left the Shadow shareholders with $125,000 less in contingent liability than they would have had with the sale through Havey. Follow-on negotiation with the bank decreased that liability by, in Hong’s case, an additional $200,000.

United and Havey sued Shadow and Mandy Hong.97 The jury found against Shadow for breach of contract, against Hong as Shadow’s alter ego, and against Shadow and Hong individually for common law fraud and conspiracy.98 The fraud, the jury said, was that Ms. Hong had promised without any intention to perform.99 Ms. Hong appealed.100

1. Subsection (a)(2)

Hong’s deception was fraud in the inducement. The court analyzed Hong’s personal liability for fraud in a similar manner to that of TecLogistics, relying on that opinion’s analysis. As in TecLogistics, the court attempted to match the facts to the statute. The court in effect held that fraud in the inducement of a contract “relates to” that contractual obligation,101 hardly an issue given the malleability of “related to.” And again the court glossed over the “on the basis of [all the veil-piercing theories of liability] or other similar theory” language. The court held that the statute applied to Hong, with a cite to TecLogistics

sale was postponed when the Hongs did not appear at the scheduled closing. Id. at 880.
93. Id. at 880.
94. Id.
95. Id.
96. Id.
97. Id. at 877.
98. Id.
99. Id. at 881.
100. Id.
101. Id. at 889–90. The court claimed that “the basis for [Havey’s] common law fraud claim” is the promise in the listing agreement that Havey’s company would receive the commission; the court also claimed that “Havey sought as damages his commission,” though as a factual matter the damages for fraud in the inducement and contract breach are identical here. Id. at 889. The court’s insistence that these are merely contract seems rigidly formalistic, especially when there is little doubt that liability for fraud in the inducement “relates to” the contractual obligation. The court continues to imply that the fraud claim sought contract damages when analyzing whether Havey and his company are obligees of Shadow Creek, though they would be contractual obligees no matter what damages Havey sought. Id. at 890.
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in support.\textsuperscript{102} (The 14th has not yet cited in support the conforming precedent from the Texarkana Court of Appeals.\textsuperscript{103})

2. Subsection (b)

The 14th doubled down against suing business owners for fraud in another part of the opinion. When the statute applies, by its terms, the protected corporate actors are not liable unless they engaged in actual fraud “primarily for the direct personal benefit of the holder . . . or affiliate.” The court held that Hong’s case did not satisfy this standard.\textsuperscript{104} The court’s reasoning is hard to follow. While the court ignored the language of subsection (a)(2), the court gave each of the words in subsection (b) a hypertechnical meaning.

The evidence showed that Hong promised to cause Shadow to use Havey’s firm exclusively even while she intended to cause Shadow to use Fuentes, also. That fraudulent promise was the basis of the jury’s

\textsuperscript{102} Id. at 890. The court also cited a second 14th court precedent from 2013, \textit{Lone Star Air Systems, Ltd. v. Powers}, 401 S.W.3d 855 (Tex. App.—Houston [14th Dist.] 2013, no pet.). The 14th court appears to have discovered \textit{Powers} after deciding \textit{TecLogistics}, as \textit{Powers} appears in support here for the first time. See \textit{TecLogistics}, 527 S.W.3d 589 (lacking any reference to the \textit{Powers} case). But the plaintiff in \textit{Powers} brought no individual, non-veil-piercing fraud claim. See \textit{Powers}, 401 S.W.3d at 862–63. Here is the quoted language: “Moreover, in light of section 21.224, the only theory of fraud available to Lone Star against Powers individually is one that requires proof that Power [sic] perpetrated the fraud for his direct, personal benefit.” Id. at 863. The sentence is clear enough: all individual fraud claims against Powers must go through the statute. But because the court already ruled that Lone Star made no tort claims of fraud against Powers individually, this statement was dicta.

Lone Star sued Powers for “breach of contract, fraud, and alter ego.” Id. at 857. Powers filed for summary judgment on the breach claim and “a hybrid no-evidence and traditional summary judgment motion on Lone Star’s ‘veil piercing claims,’ including fraud and alter ego.” Id. The trial court granted both motions, and Lone Star appealed. Id. at 857–58. In response to Powers’s claim that TBOC Sections 21.223 through 21.224 were not satisfied, Lone Star argued that it sued Powers individually, not derivatively. Id. at 863. The court’s response? No, you did not; you sued only derivatively:

Lone Star argue[d] that it did not seek to pierce the corporate veil in pursuing a claim against Powers individually for common law fraud and thus was not required . . . [to comply with the statute]. However, by its minimal fraud pleading, Lone Star does seek to hold Powers individually liable for the alleged $196,701 obligation under a contract to which he is not a party. . . .

Lone Star argues that it does not seek to pierce the corporate veil, to hold Powers liable but rather is suing Powers in his individual capacity for fraudulent acts. Again, this contention is not supported by Lone Star’s pleading, summary judgment response, or evidence.

\textit{Id.} at 862–63. Without question, the court concluded that Lone Star made no individual claim. Because Lone Star made no individual tort claim, the court could not rule on one.

\textsuperscript{103} Texas-Ohio Gas, Inc. v. Mecom, 28 S.W.3d 129 (Tex. App.—Texarkana 2000, no pet.).

\textsuperscript{104} Hong, 551 S.W.3d at 886.
fraud finding. The scheme was obviously meant to allow Hong to see which realtor obtained the higher price for the tract. The shareholders testified that their goal in selling the property was to minimize their guarantee liability on the bank loans. Yet the court held that the fraud was not “primarily for the direct personal benefit” of Hong.

The court gave essentially three arguments: (1) Hong received no cash from the transaction. Cases satisfying this “primarily for the direct personal benefit” standard, the court explains, included “evidence . . . that funds derived from the corporation’s allegedly fraudulent conduct were pocketed by or diverted to the individual defendant.” Evidence that the proceeds of fraud “were used to satisfy a corporation’s financial obligations” was insufficient. Here, “[t]he evidence does not show that the unpaid real estate commission owed to [Havey’s company] was pocketed by or diverted to Mandy. . . . [T]he evidence does not show a direct personal benefit to [Hong] from the alleged fraud.” The court therefore held that removal of her guarantee liability did not count—no pocketing or diverting occurred there.

(2) In another part, the court hung this result on the word primarily: The fraud was not “perpetrated primarily to benefit Mandy.” “Havey sought to recover the four percent commission due under the . . . agreement . . . . This commission was not directed to Mandy.”

(3) Perhaps sensing that these arguments were not very persuasive, the court added another: The connection between the fraud and the reduction of guarantee liability was too attenuated. In its argument, the court first morphed Hong’s fraudulent promise from a promise of exclusivity into a “promise, made without an intent to fulfill it, to pay Havey’s commission upon the tract’s sale to any buyer for any amount during the exclusivity period.” While these two descriptions facially cover the same facts, the second allows the court to imply that the fraud was only about the failure to pay the commission. The description is plausible only in hindsight; certainly Hong would have paid Havey’s company the commission if Havey had produced the higher offer. Hong actually promised to use Havey’s company exclusively and immediately breached that promise. But having imposed an alternative, plausible-in-post-hoc-only description on the fraudulent promise, the court then acted as if Hong merely promised falsely to pay a commission. A false promise of exclusivity is more closely tied to the

105. Id. at 881. This is the way Havey’s brief made its case.
106. Id. at 885.
107. Id.
108. Id. at 886.
109. Id. at 887.
110. Id. at 887–88.
111. Id. at 887.
112. Id.
113. Id. at 886.
114. Id.
shareholders’ professed desire to avoid paying on the guaranty; that was the point of gaming the realtors. But a false promise to pay a commission seems less related to the guarantee, because it would have been owed to one of the realtors in any event:

The extent of Mandy’s personal liability on the guaranty is not affected by whether Shadow Creek did or did not pay Havey’s promised commission because that commission was owed for any sale occurring during the exclusivity period—regardless of who bought the tract and how much was paid.115

This mischaracterization of the fraudulent promise is implausible, and the court’s conclusion is also incorrect. Hong’s failure to have Shadow pay Havey’s commission—and, as per the court’s reconstructed version of the promise, it fraudulently failed to do—certainly did “affect the scope of [Hong’s] personal liability on the guarantee.”116 Had Shadow paid the commission owed to Havey’s company, Shadow would have paid the bank that much less. The failure to pay the commission thus rendered the guarantee liability less by the amount of the commission, if nothing else.

Both the pocketed or diverted standard and the great lengths the court went to manufacture a rationalization for rejecting Hong’s fraud liability strongly suggest that business owners who commit fraud and leave the proceeds in the corporation will not be liable for their own torts, even when the influx of entity cash for their own personal economic benefit was the very goal of their fraudulent behavior.

IV. COUNTERARGUMENTS

A. The Court’s Misreading

1. The Law of Statutes

The State of Texas sends new legislative directives out every two years from Austin, but these statutes are not written in a vacuum and not intended to be interpreted according to judges’ political preferences. The Legislature itself has instructed the courts to take care. The “primary goal in statutory construction is to give effect to the Legislature’s intent.”117 Courts “rely on the plain meaning of the text as expressing legislative intent unless a different meaning is supplied by legislative definition or is apparent from the context, or the plain meaning leads to absurd results.”118

Most of Texas’s statutes about statutory interpretation and construction are common-sense rules: “Words and phrases shall be read in context and construed according to the rules of grammar and com-

115. Id.; see also id. at 887–88 (showing the court’s doubling-down on this rationale, where it essentially repeated this argument).
116. Id. at 888.
118. Id.
mon usage."119 “Words and phrases that have acquired a technical or particular meaning, whether by legislative definition or otherwise, shall be construed accordingly.”120

Others aim to protect the legislative results from misconstruction: “[I]t is presumed that . . . (2) the entire statute is intended to be effective; (3) a just and reasonable result is intended; . . . and (5) public interest is favored over any private interest.”121 Also,

In construing a statute, whether or not the statute is considered ambiguous on its face, a court may consider among other matters the:

1. object sought to be attained;
2. circumstances under which the statute was enacted;
3. legislative history;
4. common law or former statutory provisions, including laws on the same or similar subjects;
5. consequences of a particular construction;
6. administrative construction of the statute; and
7. title (caption), preamble, and emergency provision.122

The courts have added their own jurisprudence: “Where language in a statute is unambiguous, this court must seek the intent of the legislature as found in the plain and common meaning of the words and terms used.”123 “But enforcing a statute’s plain language does not mean employing a bloodless literalism in which text is viewed as if it had no context.”124

2. The Misconstruction

In TecLogistics, the court misread the statute. Here is the language again:

(a) A holder of shares, an owner of any beneficial interest in shares, . . . or any affiliate of such a holder, owner, or subscriber or of the corporation, may not be held liable to the corporation or its obligees with respect to: . . .

(2) any contractual obligation of the corporation or any matter relating to or arising from the obligation on the basis that the holder, beneficial owner, . . . or affiliate is or was the alter ego of the corporation or on the basis of actual or constructive fraud, a sham to perpetrate a fraud, or other similar theory . . . .125

As noted above in Part III.A, the court read two clauses in Section 21.223(a)(2) as if they were not part of the statute. While it may be true that the business owner in TecLogistics was sued “on the basis of

120. Id. § 311.011(b).
121. Id. § 311.021.
122. Id. § 311.023.
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actual fraud,” the business owner was not sued “on the basis of actual or constructive fraud, a sham to perpetrate a fraud, or other similar theory.”126 These are each theories of veil-piercing liability named as such in Castleberry and other Texas cases;127 they are the background against which the statute was written. The 14th reads the statute as if “actual . . . fraud” is not part of the rest of the statute that says what kind of theory of actual fraud is at issue. The court should read the statute as a whole, not select out phrases.

Moreover, “[w]ords and phrases that have acquired a technical or particular meaning, whether by legislative definition or otherwise, shall be construed accordingly.”128 The courts in Castleberry and other cases gave a technical meaning to “actual fraud”—a theory of derivative liability similar in effect to (or part and parcel with—it was sometimes hard to tell129) “constructive fraud, a sham to perpetrate a fraud, or other similar theory” and similar in effect also to the non-fraud wing of Texas veil-piercing jurisprudence, “alter ego.” The phrase “actual fraud” appears in the statute because of its use in Castleberry and related cases to refer to a theory of veil-piercing liability.130 The phrase in the statute does not mean the tort of fraud.

In fact, “actual . . . fraud” in subsection (a)(2) logically cannot mean the tort of fraud. A person who commits the tort of fraud is liable directly, and no veil piercing has ever been necessary to reach them. Subsection (b), moreover, which adds elements other than those of the tort of actual fraud, would be (and would have been) redundant, because a person committing the tort of fraud would always have been directly liable for fraud regardless of subsection (b)’s allowance of veil-piercing liability (and the damages would probably be identical to veil piercing, given subsection (b)’s elements).131

To abandon the veil-piercing meaning of “actual . . . fraud” in subsection (a)(2) is to abandon the technical meaning of the phrase and forget its context in a list of theories of veil-piercing liability. It is to change the meaning of “actual . . . fraud” in subsection (a)(2) from a theory of derivative liability to a theory of direct liability. Failure to accord the phrase “actual fraud” the technical meaning it has as a theory of veil-piercing liability would result in the oddity that this single phrase in this one subsection has one meaning when applied to a suit

127. See supra note 54.
128. TEX. GOV’T CODE ANN. § 311.011(b) (West 1985).
129. See supra note 54.
130. See supra notes 54–57 and accompanying text.
131. Regarding the meaning of “actual fraud” as a veil-piercing theory in Section 21.223, see Ricks, supra note 10, at 75–77.
by a creditor seeking to pierce the corporate veil—actual fraud the
derivative theory of liability—and another meaning when applied to a
creditor seeking a judgment that the person who committed fraud is
liable for her own tort—the tort of actual fraud. Other phrases in the
list clearly mean only the derivative theory: “alter ego” and “sham to
perpetrate a fraud” clearly refer only to a veil-piercing theory of liabil-
ity. Those phrases also carry the technical meanings of those terms as
established by Castleberry and other cases.132 No reason exists to
think that the legislature meant to sneak secondary meanings in for
actual fraud and (presumably) for constructive fraud. Nothing in the
lists suggests those terms are any different in kind than alter ego and
sham to perpetrate. The key word similar in the catch-all clause at the
end, “or other similar theory,” would hardly make sense if the items in
the list were not similar in this key respect.

Finally, the 14th’s decisions ignore the context of Section 21.223 it-
self when those decisions presume that legislation in the corporate
code means to exempt certain actors within corporations from tort
liability for those individuals’ own torts. In this respect also, the court
misreads “on the basis of.” The basis of liability of a judgment against
a person who commits actual fraud the tort is not the imposition of the
corporate liability on the shareholder, owner, or affiliate. It is not a
derivative liability, nor is it agency law or a special facet of any law of
business entities. The basis of liability of a judgment against a person
who commits actual fraud is the legal, moral, and personal responsibil-
ity not to hurt others intentionally—a legal duty imposed on all citi-
zens equally by the common law of tort.133 To read a statute ostensibly
addressed only to veil-piercing claims against corporate actors to ex-
empt them from the personal responsibility that every other citizen of
the state has—a duty not to seek property and profit by deceiving
others—is to read a statute of the corporate code far outside of its
corporate context.134

132. See, e.g., Castleberry v. Branscum, 721 S.W.2d 270, 271–73 (Tex. 1986); Rose v.
Intercontinental Bank, N.A., 705 S.W.2d 752, 756 (Tex. App.—Houston [1st Dist.]
1986, writ ref’d n.r.e.) (describing veil-piercing law as requiring that “the corporation
must be used by the individual as an unfair device to achieve an inequitable result or
as a sham to perpetrate a fraud, or to avoid a personal liability”); Tigrett v. Pointer,
580 S.W.2d 375, 385 (Tex. App.—Dallas 1978, writ ref’d, n.r.e.) (describing alter ego,
 fraud, and constructive fraud); see also, e.g., supra notes 54–58 and accompanying
text.

133. See Anderson v. Durant, 550 S.W.3d 605, 614 (Tex. 2018) (“Texas law has long
imposed a duty to abstain from inducing another to enter into a contract through the
use of fraudulent misrepresentations. Fraudulent inducement is a species of common-


134. The 14th’s reading would be more plausible for a statute such as TBOC Sec-


tion 152.801(a): “Except as provided by the partnership agreement, a partner is not
personally liable to any person, including a partner, directly or indirectly, by contribu-
tion, indemnity, or otherwise, for any obligation of the partnership incurred while the
partnership is a limited liability partnership.” If the partner’s own tortious conduct
created the partnership’s obligation, does the statute create an exemption from per-
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To this last argument, the TecLogistics court seems to have responded in the following way:

But, a corporation is a separate legal entity from its shareholders, officers, and directors, and as a general rule, “the actions of a corporate agent on behalf of the corporation are deemed the corporation’s acts.” Holloway v. Skinner, 898 S.W.2d 793, 795 (Tex. 1995). For Treurniet to be individually liable for these acts, more is required.135

The court reads into the Holloway quote that the acts of the agent are not also her own acts (something the Holloway court wanted to say). But the Holloway statement’s appearance in TecLogistics is both misplaced and incorrect. The statement is misplaced because, if the statement were true in the context of TecLogistics, then TecLogistics would not have had to address the veil-piercing statute at all; the rule from Holloway would have rendered Treurniet immune already, without the veil-piercing statute. The court’s entire analysis of the statute assumes that the rule from Holloway has no such effect in TecLogistics. The statute can only render an actor immune from liability if she was subject to liability in the first place. Thus, not even the 14th thought the Holloway language to have the effect the court suggests in this passage.

The statement is incorrect, too. The court calls it “a general rule,” and it is not.136 The Supreme Court of Texas said what the 14th quoted, but the court later clarified that “a corporate agent is person-
ally liable for his own fraudulent or tortious acts.” 137 The court explained the distinction with an example from a negligence case:

[I]ndividual liability arises only when the officer or agent owes an independent duty . . . to the injured party apart from the employer’s duty . . . . For example, an agent whose negligence causes an auto accident may be held individually liable along with his or her employer when driving in the course and scope of employment. . . . Because the agent owes a duty of reasonable care to the general public regardless of whether the auto accident occurs while driving for the employer, individual liability may attach.138

And in the context of fraud in the inducement, at issue in Hong, the principle is the same: “[T]he legal duty not to fraudulently procure a contract is separate and independent from the duties established by the contract itself.”139 Thus, courts hold generally along this line: “[A] corporate agent is personally liable for his own fraudulent . . . acts.”140 The 14th itself so holds (or held).141

137. Miller v. Keyser, 90 S.W.3d 712, 717 (Tex. 2002) (holding corporate officers could be liable under the DTPA for misrepresentations); Leyendecker & Assocs. v. Wechter, 683 S.W.2d 369, 375 (Tex. 1984) (“A corporation’s employee is personally liable for tortious acts which he directs or participates in during his employment.”); see also Alexander v. Kent, 480 S.W.3d 676, 697–98 (Tex. App.—Fort Worth 2015, no pet.) (“The general rule in Texas has always been that a corporation’s employee is personally liable for tortious acts which he directs or participates in during his employment.”) (internal quotations omitted)); Khan v. GBAK Props., Inc., 371 S.W.3d 347, 359 (Tex. App.—Houston [1st Dist.] 2012, no pet.) (“If a corporate agent directs or participates in a tort during his employment, he faces personal liability for the tortious act.”); see also Poole v. Hous. & T.C. Ry. Co., 58 Tex. 134, 137–38 (1882) (holding that neither the limitations of privity of contract nor the agency status of an attorney shielded the attorney from liability for his own fraud); Likover v. Sunflower Terrace II, Ltd., 696 S.W.2d 468, 472 (Tex. App.—Houston [1st Dist.] 1985, no writ) (holding similarly to Pool for an attorney).


139. Formosa Plastics Corp. USA v. Presidio Eng’rs & Contractors Inc., 960 S.W.2d 41, 46–47 (Tex. 1998) (“[A]n independent legal duty, separate from the existence of the contract itself, precludes the use of fraud to induce a binding agreement.”) (holding that the economic loss rule does not preclude a fraudulent inducement claim).

140. Miller, 90 S.W.3d at 717; see also Chico Auto Parts & Serv., Inc. v. Crockett, 512 S.W.3d 560, 575 (Tex. App.—El Paso 2017, pet. denied) (“We agree . . . that a plaintiff may sue a corporation’s affiliate for his torts, including fraud, without the need to pierce the corporate veil.” (citing Miller)); Key v. Richards, No. 03-14-00116-CV, 2016 WL 240773, at *2 (Tex. App.—Austin Jan. 13, 2016, no pet.) (mem. op.) (citing Miller & Leyendecker & Assocs.); Alexander v. Kent, 480 S.W.3d 676, 697–98 (Tex. App.—Fort Worth 2015, no pet.) (citing Miller, and also holding that the suit for individual fraud could proceed against the corporate officer); Shafipour v. Rischon Dev. Corp., No. 11-13-00212-CV, 2015 WL 3454219, at *8 (Tex. App.—Eastland May 29, 2015, pet. denied) (“In an action seeking to hold an officer liable for his fraudulent statements, the corporate veil is not required to be pierced.”) (citing Miller, and also holding that a suit for individual fraud could proceed against a corporate president); Maes v. Quintanilla, No. 13-13-00005-CV, 2015 WL 1957548, at *10 (Tex. App.—Corpus Christi–Edinburg Apr. 30, 2015, pet. denied) (citing Miller, and also holding that a suit for individual fraud could proceed against a corporate officer and shareholder); Majestic Cast, Inc. v. Khalaf, No. 05-12-00112-CV, 2013 WL 4568203, at *4 (Tex. App.—Dallas Aug. 26, 2013, no pet.) (citing Miller, and also holding that a suit
Holloway is not inconsistent with the general rule for tortious conduct; Holloway’s statement is a limited exception to it. Holloway’s language applies (to hold that the corporation alone is liable) only when the agent has no independent duty. When the entity alone has a duty and the person serving as its agent has no independent duty, then that person’s actions while serving as agent are merely the entity’s. “[A] party to a contract cannot tortiously interfere with its own contract.”142 In Holloway, the entity’s duty was merely contractual, and the directors and officers were not parties to the contract. The alleged tort was inducing a corporation to violate a contractual obligation. In such a case, the court held that the agent’s liability turned on whether the agent “acted in a fashion so contrary to the corporation’s best interests that his action could only have been motivated by personal interests.”143 (If the corporate actor was merely acting as a corporate actor, with purely corporate motives,144 with regard to a contract that imposed duties only on the corporation, then only the corporation’s duty was at issue.) Liability thus turned on whether the agent owed an independent duty. Holloway was not new law, and its descendants and predecessors have resided quite comfortably for a couple of generations with the general rule that an agent is independently liable for her own tortious conduct.145 The same explanation applies equally to Leitch v. Hornsby,146 also sometimes cited alongside Holloway.

for individual fraud could proceed against a corporate actor who claimed he could only be held liable via veil-piercing); Sanchez v. Mulvaney, 274 S.W.3d 708, 712 (Tex. App.—San Antonio 2008, no pet.) (citing Miller, and also holding that the suit for individual fraud could proceed against an LLC member); Gore v. Scotland Golf, Inc., 136 S.W.3d 26, 32 (Tex. App.—San Antonio 2003, pet. denied) (citing Miller, and also holding that a suit for individual fraud could proceed against a corporate officer and majority shareholder).

143. Holloway, 898 S.W.2d at 796.
144. See id. at 796–98 (remanding under the court’s test because Holloway owned only 40% of the corporation’s stock and therefore his interests and the corporation’s were “not of necessity identical”).
145. See Hansen, 525 S.W.3d at 690; Latch v. Gratty, Inc., 107 S.W.3d 543, 545 (Tex. 2003); Maxey v. Citizen’s Nat’l Bank of Lubbock, 507 S.W.2d 722, 726 (Tex. 1974) (“It has been held that an officer or director may not be held liable in damages for inducing the corporation to violate a contractual obligation, provided that the officer or director acts in good faith and believes that what he does is for the best interest of the corporation.”); Sw. States Oil & Gas Co. v. Sovereign Res., Inc., 365 S.W.2d 417, 422 (Tex. App.—Dallas 1963, writ ref’d n.r.e.).
146. Leitch v. Hornsby, 935 S.W.2d 114, 117–18 (Tex. 1996). Leitch dealt only with a duty of workplace safety, and the agents sued owed no independent duty:

Leitch and Crews had no individual duty as corporate officers to provide Hornsby with a safe workplace. The duty to provide a safe workplace was a nondelegable duty imposed on, and belonging solely to, Pro Com. The record does not show a breach of any other duty by Leitch and Crews. Because a corporate officer acting on the corporation’s behalf does not owe a corpo-
As noted above, Section 21.224 can do nothing to save the 14th’s analysis.\textsuperscript{147} That section’s effect is limited only to the veil-piercing liability addressed by Section 21.223. Nor can Section 21.225 assist.\textsuperscript{148} TecLogistics and Hong really give no justification from the statute itself or from precedent for the 14th’s misconstruction of the statute’s language.

3. The New Anomaly That Is Subsection (b)

The 14th’s reading not only ignores “on the basis” and “other similar theory” and transforms “actual fraud” the veil-piercing theory into a general tort theory, further ignoring the statute’s requirement of “on the basis of”—the court’s reading also results in subsection (a) covering far more kinds of fraud than are addressed in subsection (b). This creates the strange result that the statute now protects corporate actors more comprehensively against liability for fraud they themselves commit than it protects the same corporate actors against corporate liability. One would think it would be the other way around.

The most prominent caveat to the limitation of Section 21.223(a)(2) is the explicit exclusion of subsection (b). Subsection (b) reads as follows:

\begin{quote}
(b) Subsection (a)(2) does not prevent or limit the liability of a holder, beneficial owner, . . . or affiliate if the obligee demonstrates that the holder, beneficial owner, . . . or affiliate caused the corporation to be used for the purpose of perpetrating and did perpetrate an actual fraud on the obligee primarily for the direct personal benefit of the holder, beneficial owner, . . . or affiliate.\textsuperscript{149}
\end{quote}

Subsection (b) is—merely—a carefully crafted retention of a basis for veil-piercing liability (quite appropriate following a limitation on veil-piercing liability, which is what (a)(2) actually describes). The subsection (b) theory applies only when the shareholder or affiliate “caused the corporation to be used for the purpose of perpetrating” an actual fraud on an obligee. This is language of veil-piercing; veil-piercing theories are those that require that the corporate form has been
abused—that "the corporate form has been used as part of a basically unfair device to achieve an inequitable result."150

In contrast, the open-ended, non-derivative, tort-of-fraud-based theories of liability that the 14th claims are included in subsection (a)(2)—the ones that are not similar to alter ego and sham to perpetrate a fraud—do not (as the 14t construes them) seem to require that the corporation play any role in the fraud. An affiliate—director, officer, or perhaps employee—apparently may commit any kind of common law fraud, but as long as the affiliate does not "cause[] the corporation to be used for the purpose of perpetrating" it (something a mere employee usually has no power to do in any event), then subsection (b) does not apply. No amount of harm done to the obligee will matter.

The 14th's theory thus creates an odd set of cross-purposes. Without the 14th's theory, the statute as a whole fulfills its commonly understood purpose to tighten up the standards for veil-piercing liability, and (a)(2) and (b) work together with regard to contract and contract-related veil-piercing liability to make sure that veil-piercing liability only occurs when conditions set forth in (b) are satisfied. But under the 14th's theory, subsection (a)(2) now has a second goal: to exempt corporate actors from liability for the fraud-based torts they personally commit. And as to this, subsection (b) says nothing; it will apply only in the fluke of a case in which veil-piercing liability would also apply to the conduct for which the person is personally exempt. The logically odd result is that a corporate actor is now more likely—when subsection (b) applies—to be found liable derivatively for a tort she did not commit than she is to be found liable for the torts she personally committed—to which subsection (b) does not really apply.

This odd result suggests that the 14th has misread the statute. The presence of a limited allowance of veil-piercing liability and the absence of any similar limitation on the far broader and more sweeping


We have never held corporations liable for each other’s obligations merely because of centralized control, mutual purposes, and shared finances. There must also be evidence of abuse, or as we said in Castleberry, injustice and inequity. By “injustice” and “inequity” we do not mean a subjective perception of unfairness by an individual judge or juror; rather, these words are used in Castleberry as shorthand references for the kinds of abuse, specifically identified, that the corporate structure should not shield—fraud, evasion of existing obligations, circumvention of statutes, monopolization, criminal conduct, and the like. Such abuse is necessary before disregarding the existence of a corporation as a separate entity. Any other rule would seriously compromise what we have called a “bedrock principle of corporate law”—that a legitimate purpose for forming a corporation is to limit individual liability for the corporation’s obligations.

Id. at 455.
exemption from personal liability for personally committed fraud strongly suggests this misreading. The statute chokes on the gnat of veil-piercing liability while swallowing whole the camel of an exemption from the more basic and foundational tort of actual fraud.

4. Legislative Intent

Perhaps sensing the inadequacy of the argument from “plain language” that lawyers in Houston and the 14th itself failed to notice for twenty years, the TecLogistics court attempted to explain how a statute designed to address derivative liability somehow now creates an exemption from tort law. Its recitation of legislative history is aimed at this explanation, but nothing in the legislative history supports the court’s result.

The general history of the statute is familiar to Texas corporate practitioners. The amendments that make up the statute’s present form began in 1989. At first, the 14th said,

the statute protected only shareholders . . . and owners of a beneficial interest in shares; shielded them only from the corporation’s contractual obligations; and applied only if the claimant sought to hold an individual liable based on actual fraud, constructive fraud, sham to perpetrate a fraud, or failure to observe corporate formalities and statutory requirements.

The statute was changed slightly in 1993 to expressly “preempt[ ] . . . the common law” and also to add “alter ego” and the language “other similar theory.” Those changes occurred in 1993, and no one claims the 1993 changes expanded the statute’s scope in the way the 14th says.

The 14th claims the 1997 amendments changed the statute fundamentally. So what happened? Here is the court’s explanation:

It was not until 1997 that the statute reached its current breadth. At that time, the legislature expanded the scope of the statute’s protection so that covered persons were protected from liability not only for the corporation’s contractual obligations but also for “any matter relating to or arising from the obligation.” The legislature also

151. TecLogistics, Inc. v. Dresser-Rand Grp., Inc., 527 S.W.3d 589, 599–600 (Tex. App.—Houston [14th Dist.] 2017, no pet.). The court’s argument is similar to that of Glenn West, an early advocate of the TecLogistics result. See Glenn D. West & Adam D. Nelson, Corporations, 57 S.M.U. L. Rev. 799, 804–09 (2004); West & Chao, supra note 57, at 1403–08; Glenn D. West & Brandy L. Treadway, Corporations, 55 S.M.U. L. Rev. 803, 811–16 (2002). Incidentally, West calls the personal tort liability of corporate officials for acts done within their capacity as corporate agents a principle of agency law, see, e.g., West & Treadway supra note 151, at 805, but agency law never created tort liability. Only tort law can do that. Agency supports this result on grounds that tort law should be left to do its work. See Restatement (Third) of Agency § 7.01 & cmt. b (Am. Law Inst. 2006).

152. TecLogistics, 527 S.W.3d at 599.

enlarged the classes of persons who were protected by the statute to include not only shareholders, subscribers, and owners of beneficial interests in shares, but also “any affiliate thereof or of the corporation.” An “affiliate” was defined as “a person who directly or indirectly through one or more intermediaries controls, is controlled by, or is under common control with a specified person.” With this change, the statute began to shield those with the right to control the corporation, even if they had no actual or beneficial ownership interest.154

But shield them from what? Looking at the statute before and after it was amended in 1997 makes the purpose and effect of the 1997 amendments quite clear, and none of them, either alone or collectively, has the effect the court claims.

Here is the statute pre-1997, after the 1993 amendments. Note that the statute addresses only veil-piercing liability for corporate “contractual obligation.” The statute offers no protection at all for shareholders or other corporate controllers with regard to veil piercing for corporate torts.

A. A holder of shares, an owner of any beneficial interest in shares, or a subscriber for shares whose subscription has been accepted shall be under no obligation to the corporation or to its obligees with respect to:

(1) such shares other than the obligation to pay to the corporation the full amount of the consideration, fixed in compliance with Article 2.15 of this Act, for which such shares were or are to be issued;

(2) any contractual obligation of the corporation on the basis that the holder, owner, or subscriber is or was the alter ego of the corporation, or on the basis of actual fraud or constructive fraud, a sham to perpetrate a fraud, or other similar theory, unless the obligee demonstrates that the holder, owner, or subscriber caused the corporation to be used for the purpose of perpetrating and did perpetrate an actual fraud on the obligee primarily for the direct personal benefit of the holder, owner, or subscriber; or

(3) any contractual obligation of the corporation on the basis of the failure of the corporation to observe any corporate formality, including without limitation: (a) the failure to comply with any requirement of this Act or of the articles of incorporation or bylaws of the corporation; or (b) the failure to observe any requirement prescribed by this Act or by the articles of incorporation or bylaws for acts to be taken by the corporation, its board of directors, or its shareholders.

B. The liability of a holder, owner, or subscriber of shares of a corporation for an obligation that is limited by Section A of this article is exclusive and preempts any other liability imposed on a holder, owner, or subscriber of shares of a corporation for that obligation.

154. TecLogistics, 527 S.W.3d at 599–600 (citations to the statute and legislative enactments omitted).
under common law or otherwise, except that nothing contained in this article shall limit the obligation of a holder, owner, or subscriber to an obligee of the corporation when:

(1) the holder, owner, or subscriber has expressly assumed, guaranteed, or agreed to be personally liable to the obligee for the obligation; or

(2) the holder, owner, or subscriber is otherwise liable to the obligee for the obligation under this Act or another applicable statute. 155

Beginning with this language, the 1997 amendments changed two things:

First, the 1997 amendments did indeed add “affiliates” to the list of protected persons. The 1997 amendment adding “affiliate” did not define “affiliate” for the predecessor of Sections 21.223–225, but another part of the same bill did define “affiliate,” adopting a definition all but identical to the one found in the statute today. 156 No reason exists to suppose that the courts would not have drawn on a definition enacted in the same bill. 157 The TBOC later set forth a general definition that drew directly from the language of the 1997 amendment, 158 a definition taken from the federal securities laws. 159 That is the definition in the code today: “a person who controls, is controlled by, or is under common control with another person.” 160

But these amendments do not change any substantive protection of the statute—protections against veil-piercing liability; they merely add another set of persons to those who are protected. Adding a controlling person to the list of persons protected by the statute is logical and consistent with the statute’s purpose of limiting veil-piercing liability.

155. Supra note 153.

156. Act of May 28, 1997, 75th Leg., R.S., ch. 375, § 47, 1993 Tex. Gen. Laws 1516, 1556 (expired Jan. 1, 2010). The definition adopted for Art. 13.02 of the Texas Business Corporations Act stated that affiliate “means a person who directly or indirectly through one or more intermediaries controls, is controlled by, or is under common control with a specified person.” The TBOC now states that affiliate “means a person who controls, is controlled by, or is under common control with another person.” TEX. BUS. ORGS. CODE ANN. § 1.002(1).

157. The 1997 amendments also added the word affiliate to several of the common definitions in the Business Corporation Act without adding affiliate itself to the list of definitions. See Act of May 28, 1997, 75th Leg., R.S., ch. 375, § 1, art. 1.02.A(2), (12), (15), 1997 Tex. Gen. Laws 1516, 1516 (expired Jan. 1, 2010). Probably the 1997 amendments intended a court to draw the meaning of affiliate from the same bill in which the word was added to the code.

158. Tex. H.B. 1156, 78th Leg., R.S. (2003) (stating straightforwardly the definition and its source: “‘Affiliate’ means a person who controls, is controlled by, or is under common control with another person.”).


160. TEX. BUS. ORGS. CODE ANN. § 1.002(1).
A person can be subject to veil-piercing liability even though she is not a shareholder, director, or officer, so long as that person controls the corporation.\(^{161}\) Otherwise, a controlling person could avoid veil-piercing liability merely by selling shares to or appointing others to positions or simply not selling shares to anyone or appointing anyone to any positions at all.\(^{162}\) The addition of affiliates to the protections of the statute also closes an obvious loophole for a parent corporation and the non-shareholding officer, both controlling persons.\(^{163}\) The “controlled” person was also made an affiliate. The addition of this language also closes an obvious loophole for a subsidiary.\(^{164}\) Adding “affiliate” to the class of protected persons did not change the protections themselves.

Second, the 1997 amendments added the language “or any matter relating to or arising from the obligation,” referring to the contractual obligation.\(^{165}\) But that language also does not change the kind of protection the statute offers. The impetus for this change is obvious and unrelated to any exemption from tort law. Before 1997, the statute did not modify veil-piercing liability for corporate torts. It only modified derivative liability for corporate “contractual obligation.”\(^{166}\) But this changed in 1997, and the additional language in (a)(2) was a natural expansion along those lines. Here is the 1997 amendment with deletions struck through and additions in italics:

\[\begin{align*}
A. \text{A holder of shares, an owner of any beneficial interest in shares, or a subscriber for shares whose subscription has been accepted, or any affiliate thereof or of the corporation, shall be under no obligation to the corporation or to its obligees with respect to:} \\
\quad (1) \text{such shares other than the obligation, if any, of such person to pay to the corporation the full amount of the consideration, fixed in compliance with Article 2.15 of this Act, for which such shares were or are to be issued;} \\
\quad (2) \text{any contractual obligation of the corporation or any matter relating to or arising from the obligation on the basis that the holder, owner, as subscriber, or affiliate is or was the alter ego of the corporation, or on the basis of actual fraud or constructive}
\end{align*}\]

\(^{161}\) This most famously occurred in the case of Kinney Shoe Corp. v. Polan, 939 F.2d 209, 213 (4th Cir. 1991), which held a corporate organizer derivatively liable for the corporation’s contractual liability. The corporation in that case had never sold any shares and had no directors or officers. Id. at 212.

\(^{162}\) This was the case in Polan. Id. at 213.

\(^{163}\) See, e.g., Bell Oil & Gas Co. v. Allied Chem. Corp., 431 S.W.2d 336, 337, 341 (Tex. 1968) (holding parent not liable for obligations of subsidiary “affiliated corporation”).

\(^{164}\) See, e.g., Gentry v. Credit Plan Corp. of Hous., 528 S.W.2d 571, 575–76 (Tex. 1975) (holding subsidiary to be alter ego of parent); Siboney Corp. v. Dresser Indus., Inc., 521 S.W.2d 639, 642 (Tex. App.—Houston [1st Dist.] 1975, writ ref. n.r.e.) (parent not liable for obligation of subsidiary “controlled by” it).


\(^{166}\) Supra note 153 (the 1993 amendment).
fraud, a sham to perpetrate a fraud, or other similar theory, unless the obligee demonstrates that the holder, owner, or subscriber, or affiliate caused the corporation to be used for the purpose of perpetrating and did perpetrate an actual fraud on the obligee primarily for the direct personal benefit of the holder, owner, or subscriber, or affiliate; or
(3) any contractual obligation of the corporation on the basis of the failure of the corporation to observe any corporate formality, including without limitation: (a) the failure to comply with any requirement of this Act or of the articles of incorporation or bylaws of the corporation; or (b) the failure to observe any requirement prescribed by this Act or by the articles of incorporation or bylaws for acts to be taken by the corporation, its board of directors, or its shareholders.

B. The liability of a holder, owner, or subscriber of shares of a corporation or any affiliate thereof or of the corporation for an obligation that is limited by Section A of this article is exclusive and preempts any other liability imposed on a holder, owner, or subscriber of shares of a corporation or any affiliate thereof or of the corporation for that obligation under common law or otherwise, except that nothing contained in this article shall limit the obligation of a holder, owner, or subscriber, or affiliate to an obligee of the corporation when:
(1) the holder, owner, or subscriber, or affiliate has expressly assumed, guaranteed, or agreed to be personally liable to the obligee for the obligation; or
(2) the holder, owner, or subscriber, or affiliate is otherwise liable to the obligee for the obligation under this Act or another applicable statute.167

The reader can see what happened. When the word “contractual” was deleted from (a)(3), the statute’s reach expanded for the first time also to cover derivative liability for corporate torts. This expansion of (a)(3) raised the immediate question whether (a)(2) should also expand. The legislature’s answer was “yes, but not as far as (a)(3).” The vehicle for the expansion was the language “or any matter relating to or arising from the obligation.” The language specifies what kind of corporate liability besides “contractual obligation” will also be covered by the limitations in (a)(2).

The legislature obviously wanted the protections of (a)(2) to apply more than to merely the contractual obligations of the corporation. This must have included some tort liability, and to this extent, the 14th has read the statute correctly. Liability in contract does not extend beyond corporate contractual obligations, so the added language obviously meant to expand to something else. Because the statute elsewhere preserves liability for statutory violations,168 this other liability must be common law liability. Tort liability is the obvious candidate.

But whose tort liability? Only the corporation’s. The statute’s other language limits the reach of the statute to veil-piercing liability, and *nothing else in the statute changed*. The language was inserted in the middle of a statute addressing veil-piercing liability, not placed floating freely on its own. Thus, notwithstanding that the kind of liability named in (a)(2) is more than “any contractual obligation of the corporation” and quite clearly includes some liability in tort “relating to or arising from” contract, the protection offered by the statute is the same, namely, protection against veil-piercing liability—liability “on the basis that the [person protected] is or was the alter ego of the corporation, or on the basis of actual fraud or constructive fraud, a sham to perpetrate a fraud, or other similar theory.”\(^{169}\) The language describing the basis of liability did not change in 1997: “on the basis of,” “other similar theory,” etc.—remained identical.\(^{170}\) The added language must be read in the context of the statute in which it was placed, against the statute’s history, and the statute must be read as a whole. Nothing changed except the description of the kind of corporate liability to which (a)(2) applied. The statute still addressed only veil-piercing liability.

Simplified, the statute says, “C shall have no liability for E on the basis of F.” C can be expanded to include any variety of persons. E can be expanded to include anything, but it will always be limited by “on the basis of F.” F in this statute is veil-piercing theory—the liability of a corporate actor for the corporation’s obligations, and its description remained the same in the 1997 amendments.

I imagine a counter-argument; perhaps this is a hidden premise in the 14th’s understanding: Corporate tort liability is different from corporate contractual liability. Whereas the agent of a disclosed principal can form a contract for the corporation such that the agent is not a party, a corporation can never be liable in tort except vicariously, so a limit on liability for a corporation’s torts must also include a limit on the liability of the agent who generated the liability.

The premise is false. Veil-piercing liability remains separate and distinct from direct liability for the fraud of the agent who committed the fraud. Perhaps the objector is thinking only of cases in which the dominating shareholder is the same person who committed the fraud, as in both *TecLogistics* and *Hong*, though this should make no difference because the bases of liability are different, and that is what matters. Moreover, that is not the only way reality can happen. A case in which the person committing the fraud is not the dominating shareholder (or is one of two dominating shareholders) illustrates.

Consider the case of actor X who owns, controls, and dominates Corporation; fails to help it perform any corporate formalities; and

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169. *Id.* § 21.223(a)(2).
170. *Id.*
strips it of its cash by distributing all profits as salary and bonuses and commingling her own assets with Corporation’s such that it is impossible to tell where Corporation begins and X ends. Imagine X is a particularly bad actor who defrauds some unnamed clients. Now Corporation hires Z to manage part of its business and lets Z buy some shares. X and Z are of a similar frame of mind, which is why they get along. Z commits fraud against Client A in the conduct of Corporation’s business. The fraud might even also be a breach of contract, like the fraud in *TecLogistics*. X has no contact with Client A.

Whom should Client A sue? The statute according to its language protects X. X did not commit this fraud, so the only theory of liability possible against X is a derivative theory, veil piercing. Since the liability at issue is contractual (breach) and related closely to the contract (fraud in the performance of a contract), subsection (a)(2) (and (a)(3)) applies and protects X against any corporate liability—veil-piercing liability. X has no direct liability because X did not commit a tort.

But the statute does not protect Z against a direct fraud claim. The basis of Z’s liability is not derivative, not veil-piercing; it is direct under tort law for the fraud that Z committed. The tort of fraud is not similar to the veil-piercing theories named in (a)(2), and the basis of the suit against Z would not be any veil-piercing theory, so the statute does not apply. Client A should sue Z and also Corporation itself because this fraud was within the scope of Z’s authority.

Incidentally, the statute probably protects Z from a veil-piercing claim so long as Z did not use Corporation to commit the fraud as required by subsection (b). Z probably did not abuse the corporate privilege, so even if Z is liable for the fraud she committed, no veil-piercing is warranted. In this case, the damages will be the same no matter the ground of liability, because Corporation’s liability resulted solely from Z’s fraudulent act within the scope of employment or authority; Corporation’s liability is derivative of Z’s. But lawyers should understand the distinction between (i) (a) Z’s direct liability for tort and (b) Corporation’s derivative liability for Z’s tort under agency law, on the one hand, and (ii) derivative liability for veil-piercing, on the other.

In any event, X is not liable. X committed no fraud against Client A. X is not liable derivatively under agency law because Corporation, not X, is the principal. X is protected from derivative liability for veil-piercing by the statute.

The corporate liability named in Section 21.223(a)(2)—that is contractual and that is tortious but related to a contract in some way—is a rational category for the legislature to address as a regulation of veil piercing. That is what the statute does. Nothing in the legislative history suggests the statute was intended to do anything else. That the basis of liability affected by Section 21.223(a)(2) and its predecessors
remained the same throughout the amendments—every amendment up until the present day—means that Section 21.223(a)(2) did not expand beyond veil-piercing. This conclusion is supported also by the (one would hope) unnoticed and unintended consequences of reading the statute as the 14th has.

B. **Unexpected and Unwanted Results: When No One Is Liable for Fraud**

One of the real oddities of the 14th’s position is that it protects fraud for which no one will be liable. Under the 14th’s theory, sometimes fraud pays. It certainly pays for the individual who commits fraud but has no liability. The individual gains whatever personal benefit she wanted from committing fraud (e.g., greater financial security for her business, a higher year-end bonus, a promotion) and never pays a dime to the victim. But under the 14th’s theory, sometimes no one will be liable for fraud.

1. Whither Vicarious Liability

A corporation can be liable in tort only because of the acts of its agents; the corporation itself is a mere legal fiction. Liability for fraud in Texas can attach to the principal if the fraud was within the agent’s scope of employment, under “respondeat superior.” Respondeat superior liability is vicarious liability, not direct—“purely of a derivative or a secondary character.” There may be other bases for imposing liability for fraud on a corporation, but Texas law seems to settle on vicarious liability.

171. GTE Sw., Inc. v. Bruce, 998 S.W.2d 605, 618 (Tex. 1999) (“Corporations can act only through their agents.”).


173. Fort Worth Transp. Auth. v. Rodriguez, 547 S.W.3d 830, 847 (Tex. 2018) (“indirect or vicarious liability under the doctrine of respondeat superior”); Painter v. Amerimex Drilling I, Ltd., 561 S.W.3d 125, 130 (Tex. 2018) (“Under the common-law doctrine of respondeat superior, or vicarious liability, ‘liability for one person’s fault may be imputed to another who is himself without fault solely because of the relationship between them.’”).


175. It is possible that the agent acts with actual authority or that the principal ratifies the tort. See Restatement (Third) of Agency § 7.04. Evidence of actual
But what happens to vicarious liability when the employee is not liable? The courts following the 14th’s theory seem to have assumed that the employer remains liable, but why would it? Its liability is vicarious. Tellingly, the governmental liability version of respondeat superior requires explicitly that “the employee would be personally liable to the claimant according to Texas law.” If such is not the case, then the employer is not liable. So, under the common law, if the employee is not liable—and under the 14th’s theory the employee is not—then no one is?

Section 21.223 itself leaves the vicarious liability issue wide open, probably because it was not intended to address this kind of liability in authority to commit a tort would be rare and solely within the principal’s control. If a corporate board authorized the commission of a tort, liability would be direct.

One method of imposing liability for fraud on a business entity under Texas law is known as “vice principal.” See Supply Pro, Inc. v. Ecosorb Int’l, Inc., No. 01-15-00621-CV, 2016 WL 4543136, at *12–13 (Tex. App.—Houston [1st Dist.] August 30, 2016, pet. denied); e.g., Hammerly Oaks, Inc. v. Edwards, 958 S.W.2d 387, 390–91 (Tex. 1997) (affirming the doctrine). The Supreme Court of Texas has proclaimed this kind of liability “direct rather than vicarious.” Chrysler Ins. Co. v. Greenspoint Dodge of Hous., Inc., 297 S.W.3d 248, 253 (Tex. 2009) (merely citing to Hammerly Oaks). However, this label is applied primarily because the courts declare that the controlling position of the vice principal within the business entity blurs the line between the entity and the individual sufficient to justify punitive damages against the entity. Id. (“As vice-principals, their acts are the acts of the corporation itself.”); Hammerly Oaks, 958 S.W.2d at 390–91 (“‘vice principal’ includes one who represents the corporation in its corporate capacity”). Hammerly Oaks also recognized that “[c]orporations can, of course, act only through agents of some character.” 958 S.W.2d at 391 (internal quotations omitted). Even in a case of vice principal, then, the principal’s tort liability usually depends on some agent’s having committed the tort. When it does, liability is vicarious no matter what label the court applies to it. The Restatement (Third) of Agency declares that “a principal’s vicarious liability turns on whether the agent is liable. In most cases, direct liability requires fault on the part of the principal whereas vicarious liability does not require that the principal be at fault.” RESTATEMENT (THIRD) OF AGENCY § 7.03 cmt. b. Thus, liability is vicarious even in vice principal cases when the entity’s liability depends on an agent’s commission of a tort. For example, in GTE Southwest, Inc. v. Bruce, 998 S.W.2d 605, 608 (Tex. 1999), a supervisor of a supply department with authority to direct subordinates within the department subjected them to intentional infliction of emotional distress. The Supreme Court of Texas affirmed rulings that the employer was liable for the tort under respondeat superior and also for punitive damages because the supervisor was a vice principal. Id. at 617–18. The court explained that a vice principal’s acts “may be deemed to be the acts of the corporation itself.” Id. at 618. Liability was quite clearly vicarious.

A corporate board would also be a vice principal. See id. (“those to whom the master has confided the management of the whole . . . business”). But the board’s act would also be the formal and substantive act of the corporation as principal. See TEX. BUS. ORGS. CODE § 21.401(a) (West 2019) (“the board . . . shall . . . exercise . . . the powers of the corporation”). A board-authorized tort would therefore create direct liability.

176. Valley Forge Motor Co. v. Sifuentes, 595 S.W.3d 871, 878 (Tex. App.—El Paso 2020, no pet.), seems to assume it is part of the test (“given Sifuentes' proof of transacting all business on behalf of the corporate entity, he met his . . . burden”), but the statute has no such requirement.

177. TEX. CIV. PRAC. & REM. CODE § 101.021(1)(B) (West).
the first place. Nothing in Section 21.223 mentions respondeat superior doctrines, and the statute contains no requirement that the corporate actor act within the scope of employment, with actual or apparent authority, or in any way connected to its duties. This makes perfect sense. The statute protects, among others, shareholders. Shareholders are owners and have no duties and do not act within any scope. The omission of “scope of employment” or respondeat superior doctrine from the statute might seem like an omission, but it only seems like that if one assumes the statute addresses the personal liability of named corporate actors for their own torts. The issue disappears entirely if one reads the entire statute in context and recognizes that it functions solely as a limit on veil piercing.

But let us imagine the 14th’s theory holds up. What happens to vicarious liability? In theoretical terms, the cases speak loudly if not clearly. In Knutson v. Morton Foods, Inc., the Supreme Court of Texas opined, “[W]here the employer’s liability rests solely on respondeat superior, an adjudication acquitting the employee of negligence will stand as a bar to a subsequent suit against the employer.” Is dismissal under Section 21.223 such an acquittal?

Alternatively, one could consider Section 21.223 to create some sort of immunity, which is what I call it sometimes in this Article. If it is an immunity, does it affect the doctrine of respondeat superior? It is difficult to say. The language of the courts is not clear. In Felderhoff v. Felderhoff, the parental immunity of the supervisor did not bar an action against the ranch in which the parent was a partner, but the court emphasized that the “the negligence complained of in this case is alleged to have occurred in the conduct of business activities wholly outside the sphere of parental duties and responsibilities.” No such distinction can be made with fraud committed by a corporate actor covered by the statute under the 14th’s reading; such activities are likely near the core of some corporate actor’s role within the organization. They are the very reason for the immunity.

While the Restatement (Second) of Agency suggested that an “immunity” personal to the employee will not prevent liability under respondeat superior, it recognized that the cases are not uniform.

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179. Id. at 807 n.2.
180. See Sifuentes, 595 S.W.3d at 878–79 (granting summary judgment to Sifuentes alone without regard to whether a case could be made out against the employer).
182. Id. at 933.
183. Cf. Farley v. M M Cattle Co., 529 S.W.2d 751, 758 (Tex. 1975) (making exactly the same distinction).
184. RESTATEMENT (SECOND) OF AGENCY § 217 & cmt. b (AM. LAW INST. 1958); see Langley v. Nat’l Lead Co., 666 S.W.2d 343 (Tex. App.—El Paso 1984, no writ) (holding interspousal immunity not helpful to employer). Langley reasoned that the “tort is complete by itself by the husband acting in his business as distinguished from
The Restatement (Third) seems to limit this doctrine to cases such as Holloway involving contractual liabilities and a “privilege” to make decisions about breach—not a bad description of Holloway. Should we rather say that the corporate actors addressed by the statute have a privilege to commit fraud? The precedent on this issue does not generate a clear answer, and actually, the issue itself need not be decided if the 14th’s position is not adopted because the Texas Legislature did not intend this statute to do what the 14th has held it did.

2. The Gap Between the Statute and Any Vicarious Liability

Even if vicarious liability for fraud continues notwithstanding the statute’s effect, the 14th’s reading of the statute will also make fraud pay whenever the following two conditions occur at the same time: (1) the exemption from liability under the 14th’s theory applies but (2) the corporation itself is not liable for the fraud.

When this would happen is easy to describe. According to the 14th’s theory, the exemption from liability applies whenever the corporate actor is charged with the tort of fraud or some similar theory (negligent misrepresentation, say) and the fraud “relates to or arises from” “any contractual obligation of the corporation.” Compare that description with when a corporation will be liable for fraud. A corporation will be liable for fraud committed by its employee within the scope of employment. Whenever the 14th’s theory applies to protect a corporate actor from liability for fraud but none of the laws imposing vicarious liability for fraud apply, the corporate actor is able to commit fraud without creating liability in tort for anyone.

How often will this happen? It is difficult to say. The relationship between (i) the language that the 14th construes to cover primary liability in Section 21.223 and (ii) the laws imposing vicarious liability on acts which arise from the discharge of normal spousal duties and responsibilities.”

185. Compare, e.g., M.J. ex rel. Beebe v. United States, 721 F.3d 1079, 1081 (9th Cir. 2013) (“Under Alaska state law, an employee’s immunity from tort liability precludes an employer from being held vicariously liable for the employee’s negligence.”); Law v. Verde Valley Med. Ctr., 170 P.3d 701, 703–05 (Ariz. Ct. App. 2007) (“Because the doctors were, in the eyes of the law, adjudicated to have no liability to Plaintiff, neither did [the employer] have any vicarious liability to Plaintiff based on the doctors’ conduct.”), with Hook v. Trevino, 839 N.W.2d 434, 444–45 (Iowa 2013) (holding that a driver’s immunity as a “state volunteer” did not preclude an action against the state based on the driver’s negligence).

186. See RESTATEMENT (THIRD) OF AGENCY § 7.01 cmt. e (AM. LAW INST. 2006) (“Privileged conduct,” citing Holloway).


188. The language is completely untested in court as of yet. The importance of the issue suggests that the Legislature did not intend to leave it to the courts to riddle out.
principals for the fraud of their agents—that relationship is not obvious at all. It is as if the two sets of rules were drafted for entirely different purposes (which, of course, they were).

The probability that some fraud will go unremedied persuades me that the legislature never intended the 14th’s theory. The notion that something as important as remedies for fraud was left to the uncertain overlap between open-ended language drafted for placement in a veil-piercing statute and the relatively fixed rules for vicarious liability—this notion persuades that the legislature never intended the 14th’s theory. And the idea that the legislature meant to allow any fraud to go unremedied and thus encourage fraud—as any lessening of a disincentive for an act will at the margins encourage it—likewise suggests that the legislature never intended such a thing.

How might this play out in litigation? Consider a case in which an agent without authority from the principal commits fraud outside the scope of the agent’s duties but the fraud is successful largely because the agent’s position with the principal enables the agent to commit the fraud.189 In Millan v. Dean Witter Reynolds, Inc.,190 Maria Millan opened two brokerage accounts at Dean Witter using her son Miguel, a Dean Witter broker, as her broker.191 Miguel opened an additional Dean Witter account in his mother’s name and forged her signature on the application.192 Miguel gave this account check-writing privileges and a credit card, which he used.193 He deposited his mother’s periodic deposits into this account and wrote himself checks from it.194 He covered his tracks with a P.O. Box, false change of address form, and false account statements purporting to be from Dean Witter.195

Millan sued her son and Dean Witter for fraud and other things.196 The trial court directed a verdict for Dean Witter on vicarious liability theory, and the court of appeals affirmed (over a dissent).197 So Dean Witter was not liable for the fraud of its broker Miguel. But Miguel’s bad acts were only possible because Maria Millan opened accounts at Dean Witter in the first place and used her son Miguel, a Dean Witter

189. This is a common occurrence. See Restatement (Second) of Agency § 261 & cmts. a–b, reporter’s notes case citations (Am. Law Inst. 1958) (“A principal who puts a servant or other agent in a position which enables the agent, while apparently acting within his authority, to commit a fraud upon third persons is subject to liability to such third persons for the fraud.”); see also, e.g., Restatement (Third) of Agency § 7.08 (Am. Law Inst. 2006) (providing for the same).
191. Id. at 763.
192. Id.
193. Id.
194. Id.
195. Id.
196. Id.
197. Id. at 763.
employee, as her broker. The contractual relationship between Dean Witter and Maria Millan was one source of the trust Miguel violated, which was why Miguel’s fraud involved a fake account and false Dean Witter statements.

In rejecting vicarious liability for Dean Witter, the San Antonio court of appeals said that Miguel’s bad acts “were not related to Miguel’s duties and were not within his general scope of authority as a broker for Dean Witter.” “Not related to his duties” is pretty far-fetched. But the court also conceded (1) that Miguel opened the brokerage account “in the course and scope of his employment for Dean Witter” and (2) that “[i]t was within Miguel’s general authority to open such accounts for clients, receive deposits to these accounts, and purchase and sell securities as directed by clients.” The contract between Dean Witter and Maria Millan was the stage for Miguel’s fraud play. Even if Miguel’s fraud did not relate to his own duties, it surely related to or arose from the contractual obligation of Dean Witter to Maria Millan. If it did, then Miguel would not be liable for it under the 14th’s reading, and neither would Dean Witter because vicarious liability rules did not apply. No one would be liable for it, and Maria Millan would be left with no remedy for fraud.

The Millan case raises one other issue. Even though Miguel would be protected by Section 21.223(a)(2) as construed by the 14th, might Maria employ subsection (b) to hold him liable nonetheless? Subsection (b) clarifies that subsection (a)(2) “does not prevent or limit the liability of a[n] . . . affiliate if the obligee demonstrates that the . . . affiliate caused the corporation to be used for the purpose of perpetrating and did perpetrate an actual fraud on the obligee primarily for the direct personal benefit of the . . . affiliate.” The answer is unclear.

Section 21.223(a)(2) only applies to protect Miguel if Maria is an obligee of the corporation. Let us assume that, after the fraud, Maria no longer did business with Dean Witter. Even so, Maria remained an obligee at the time of the litigation because the jury found Dean Witter negligent. Because the statute only protects corporate obligees, this finding appears necessary for Miguel to obtain statutory protection. But it also gave Maria standing to claim under subsection (b), because subsection (b)’s limitation is also only available to an obligee. Because she is an obligee, she can then argue that Miguel satisfied the rest of the requirements of subsection (b). He might be liable under subsection (b), depending on what the court thinks “caused the corpo-

198. See id. at 765–66.
199. Id. at 768.
200. Id.
201. TEX. BUS. ORGS. CODE ANN. § 21.223(b) (West 2019).
202. See id. § 21.223(a) (“a corporation or its obligees”).
203. Millan, 90 S.W.3d at 763.
ration to be used for the purpose of perpetrating” means. He certainly hid behind his office, and his use of Dean Witter’s accounts and stationary suggest a use of the corporation to commit fraud, probably actual fraud the tort. Miguel’s deceptive acts were certainly intentional and he did pocket or divert the funds. So perhaps this application of the statute is ok?

But what if the jury had exonerated Dean Witter? What if Dean Witter had settled out early? Even worse, what if, as happened in Sifuentes, the court ruled for the agent before trial without ever considering the liability of the principal (when the plaintiff was an obligee),204 and then after trial ruled for the principal? Or is “obligee” supposed to refer to a relationship established by the contract mentioned in (a)(2)? If it is, how long after the contract terminates does that last? Truth is, no one knows why corporate “obligee” status in (b) is a requirement in Maria’s tort case against Miguel. No good reason exists not to let Maria sue Miguel for the full amount of her damages.

In the veil-piercing setting, an “obligee” requirement is always met. Because in a veil-piercing setting the plaintiff is always also suing the corporation, and because veil-piercing liability is always derivative of corporate liability, the plaintiff in every veil-piercing case is an obligee. But in a case like Millan, the plaintiff is an obligee of the corporation only if the case against the corporation is successful—if the corporation still owes something. In Millan itself, the case against Dean Witter was successful on a cause of action not necessarily related to fraud. Did the legislature actually mean the statute to apply based on such a dice roll?

I seriously doubt that the legislature intended such a result or a result like it in any case, or even the risk of it. Fortunately, the legislature never intended the 14th’s reading.

3. The Insolvent Corporation

Even when corporate liability for fraud (and a corporate obligee) exists, fraud will pay under the 14th’s theory when a corporate actor covered by the statute commits fraud for the corporation while the corporation is or is about to be insolvent. Corporate actors in control of a business often take desperate measures to save it just before it goes bankrupt. That is one reason that some fraud in the vicinity of bankruptcy is addressed by Sections 544 and 548 of the Bankruptcy Code.205 But the 14th’s reading may well cut back on a trustee’s powers under Bankruptcy Code Section 544, which relies on non-bankruptcy law. Moreover, if the entity never files (or is forced into) bankruptcy, the fraudster simply gets away with it. This would be the

204. Valley Forge Motor Co. v. Sifuentes, 595 S.W.3d 871, 878–79 (Tex. App.—El Paso 2020, no pet.) (granting summary judgment to Sifuentes alone without regard to whether a case could be made out against the employer).
case under the facts of TecLogistics if TecLogistics, Inc., were unable to pay damages for fraud.

One should not expect the desperately insolvent corporation to be the only possible fraud pass, however. The courts should also expect a person worried about fraud liability to create an intentionally insolvent corporation. After all, the 14th’s reading makes no distinction. Any shareholder or manager of any corporation is, according to the 14th, worthy of such protection. One might object that the veil of an undercapitalized corporation might be pierced, but undercapitalization alone has never been sufficient to pierce a corporate veil, and it certainly is not sufficient under Section 21.223.206 Also, if the person never “pockets or diverts” her ill-gotten gains, veil-piercing will never succeed under the 14th’s theory, as Hong holds207 and Part III.B describes. Besides, given the formalistic legal rules of Section 21.223, now applied by the 14th to protect fraud, why should only business people acting in good faith be exempt from personal liability for lying and cheating? Treurniet was also protected.

C. More Unintended Results, Including the Corporation’s Loss of Rights

The 14th’s reading’s (hopefully) unintended results are not limited to leaving some fraud against third parties unremedied.

1. Exempting Fraud but Not Negligence

The statute as read by the 14th exempts the named corporate actors from personal liability for the fraud they commit in relation to a corporate contract. It does not exempt the same corporate actors from negligence relating to those same contracts. So the agent who pads a bill or lies to induce a contract counterparty to sign has no liability, but an agent who negligently drives a car on corporate business remains personally liable.208 One would have thought that the imposi-

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206. Torregrossa v. Szelc, 603 S.W.2d 803, 804–05 (Tex. 1980); Endsley Elec., Inc. v. Altech, Inc., 378 S.W.3d 15, 24 n.7 (Tex. App.—Texarkana 2012, no pet.); Ramirez v. Hariri, 165 S.W.3d 912, 916 (Tex. App.—Dallas 2005, no pet.) (“[U]ndercapitalization alone, even if established, is not a sufficient basis to disregard the corporation.” (a jurisdiction case)).

207. Hong v. Havey, 551 S.W.3d 875 (Tex. App.—Houston [14th Dist.] 2018, no pet.).

tion of personal liability was at least as effective, and even more important, a disincentive for intentional deceit as it is for negligent conduct, but the 14th’s reading inverts that judgment. The 14th’s position suggests that no need exists for such a disincentive—only for negligence.

2. Shareholders and Affiliates Who Commit Fraud
Against the Corporation

The 14th’s reading expands (a)(2)’s limitation beyond veil-piercing liability and claims that it limits personal liability for the torts the corporate actor commits against a corporate obligee. Section (a)(2) as read by the 14th now also limits corporate actors’ liability to the corporation itself. This is plain from the language of subsection (a), which says,

A holder of shares, an owner of any beneficial interest . . . , or any affiliate of such a holder, owner, . . . or of the corporation, may not be held liable to the corporation or its obligees with respect to . . . any contractual obligation of the corporation or any matter relating to or arising from the obligation . . . .209

When (a)(2) was understood to apply only to derivative, veil-piercing liability, the liability of a corporate actor to the corporation itself was not at issue; that subject is never addressed in a veil-piercing suit. But the 14th’s theory applies to personal liability, so it is not limited by the veil-piercing context or the elements and effect of veil-piercing theories. The 14th thinks that liability protected under (a)(2) can be on the basis of any kind of fraud theory. If the 14th is right, then subsection (a)(2) also prohibits a corporation from suing its own managers and employees for a variety of fraud.

One would think that if the legislature intended to exempt from personal liability corporate actors who commit fraud on the corporation, that notion would have been more explicit in the statute. This is not a result addressed in any of the 14th’s cases, but the applicability of TecLogistics to manager and employee fraud against the corporation is unavoidable under the statute’s language. Under the language of subsection (a), liability to the corporation and its obligees is treated identically. The low probability of this far-reaching and severe change being relatively hidden in a veil-piercing statute, in a 1997 amendment

reasonable care in his operation of the vehicle.”); Leitch v. Hornsby, 935 S.W.2d 114, 117 (Tex. 1996) (“[A]n agent whose negligence causes an auto accident may be held individually liable along with his or her employer when driving in the course and scope of employment.”). The same would not be true if the employer were a governmental unit. See Fort Worth Transp. Auth. v. Rodriguez, 547 S.W.3d 830 (Tex. 2018). But with the government, the plaintiff must elect either the employer or the employee; someone will be liable. This is not true of the 14th’s reading of Section 21.223.

209. TEX. BUS. ORGS. CODE ANN. § 21.223(a) (West 2007) (emphasis added).
that by itself addressed no such thing, strongly suggests that the 14th has misread the statute.

Permutations of insider fraud on the corporation are almost too numerous to name. Are not the following covered under this standard?

i) The shareholder, manager, or employee who lies to the corporation in order to sell the corporation overpriced property or services.

ii) The manager or employee (the officer who exercises some control over the corporation and as an agent is controlled by it, or the lower-level employee who is controlled by it) who pads a reimbursement request for even authorized acts. This is the same act committed by Treurniet,\(^\text{210}\) but there is no reason to think the result should be different under the 14th’s theory if the victim is the corporation. The same language mandates the same result.

(iii) The shareholder or affiliate who promises anything to the corporation without any intention to fulfill the promise. This is promissory fraud, and it occurred in \textit{Hong v. Havey} against the corporation’s obligee. The 14th will have to treat promissory fraud against the corporation in the same way.

The startling thing about all of these instances is, as noted above, that there is not even a hope of preserving liability for them. Section 21.223 as a veil-piercing statute wisely preserved liability for acts of real fraud in subsection (b), and when those occur, the statute allows the corporate obligee to recover the corporate obligation from the shareholder, officer, or other corporate actor. But subsection (b) only allows a remedy to a corporate obligee. There is no such preservation for liability to the corporation itself. Under the 14th’s theory, the corporate actor can perpetrate actual fraud against the corporation for her direct personal benefit, to use the statute’s language, and the statute protects her from liability.

3. No Indemnity or Contribution from the Corporate Actor

The 14th’s reading of the statute may create another, equally dramatic effect: When a corporate actor such as Treurniet—be she director, officer, other manager, or employee—commits a fraud as agent of the corporation such that the corporation itself becomes vicariously liable, the corporation can no longer seek indemnity from the corporate actor who actually committed the fraud.

\textit{Respondeat superior} doctrine can attach liability for fraud to a corporate principal.\(^\text{211}\) \textit{Respondeat superior} liability is vicarious,\(^\text{212}\) not

\textsuperscript{210. See generally TecLogistics, Inc. v. Dresser-Rand Grp., Inc., 527 S.W.3d 589 (Tex. App.—Houston [14th Dist.] 2017, no pet.).}

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direct—“purely of a derivative or a secondary character.”

Under respondeat superior, a corporation without fault—not a tortfeasor—becomes liable for the tort of another. The doctrine is “a deliberate allocation of risk” to a non-tortfeasor because that non-tortfeasor “is in a position to exercise some general control over the situation”. Allocation of risk to the person in control encourages the controlling actor to improve the conduct of the agents it has the right to direct. Other kinds of vicarious liability also exist, such as the vice principal doctrine.

These doctrines are means by which a corporation, itself a fiction, becomes liable to pay tort damages. TecLogistics, Inc., became liable for the fraud of Treurniet vicariously.

The common law right of indemnity protects a defendant whose liability is “purely vicarious.” Without the 14th’s reading of the statute, agents who subject their principals to vicarious liability for fraud because of acts they commit within the scope of their authority are liable to the principal to indemnify the principal for the amounts the principal must pay to the victims of the agents’ fraud. However, when the 14th’s reading of the statute applies to protect a corporate

212. Rodriguez, 547 S.W.3d at 847 (“indirect or vicarious liability under the doctrine of respondeat superior”); Painter v. Amerimex Drilling I, Ltd., 561 S.W.3d 125, 130 (Tex. 2018) (“Under the common-law doctrine of respondeat superior, or vicarious liability, ‘liability for one person’s fault may be imputed to another who is himself without fault solely because of the relationship between them.’”).


215. Id. at 131 (quoting W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS § 69 (5th ed. 1984)).

216. E.g., Hammerly Oaks, Inc. v. Edwards, 958 S.W.2d 387 (Tex. 1997); supra note 175.

217. See generally TecLogistics, Inc. v. Dresser-Rand Grp., Inc., 527 S.W.3d 589 (Tex. App.—Houston [14th Dist.] 2017, no pet.). It is possible that Treurniet as the board of TecLogistics, Inc., authorized the corporation to commit fraud, in which case TecLogistics could have been found directly liable, see RESTATEMENT (THIRD) OF AGENCY § 7.03(a)(1)(a) (AM. LAW INST. 2006), but the case reported no evidence of any such authorization. Such evidence, while extremely rare, would be within the defendants’ control. Courts also sometimes separately justify corporate liability for fraud on the doctrine of apparent authority. See id. § 7.04; Chubb & Son Inc. v. Consoli, 726 N.Y.S.2d 398, 400 (N.Y. App. Div. 2001).


agent, that agent is not liable to the corporation for fraud or similarly
tortious conduct relating to or arising from any contractual obligation
of the corporation. For this reason, the corporation cannot recover
indemnity from the employee. The corporation’s liability carrier who
has a right of subrogation also cannot recover from the employee.
Thus, TecLogistics, Inc., could not recover from Treurniet the fraud
damages she caused it to pay because of her fraud. The same would be
ture of any corporation seeking to recover indemnity from an execu-
tive who had committed some fraud-like tort within the scope of her
authority; the merely vicariously liable corporation would bear the lia-
ibility alone.

Texas courts have also held that “[t]here is no right of indemnity
against a defendant who is not liable to the plaintiff.” Because the
corporate actor protected by the statute is not liable to the corpora-
tion’s obligee, the corporate actor is also not liable to the corporation
for indemnity. For this reason also, TecLogistics, Inc., could not re-
cover from the defrauding employee under the 14th’s reading of the
statute.

A similar analysis holds for contribution. “[C]ontribution and in-
demnity are distinct concepts.” “[I]ndemnity involves a shift in re-
ponsibility for payment of damages . . . whereby one pays the entire
amount due by another.” Contribution, on the other hand, is an
obligation to make up one’s share of common liability. Because the
liability must be common, contribution is not “recoverable from a
party against whom the injured party has no cause of action.”
Because under the 14th’s reading of the statute the corporate obligee has
no cause of action against the corporate actor who committed the
fraud, the corporation and its insurer will shoulder the liability for the
fraud alone.

What would this mean in a litigation context? Consider J.M.K. 6,
Inc. v. Gregg & Gregg, P.C., a decision by the 14th Court of Ap-
peals itself. The corporation J.M.K. 6, Inc., (“JMK”) hired Gregg as its
agent to do the legal work of converting apartments to condos. In
the course of his work, Gregg allegedly participated in a phone call
with JMK and two potential buyers of condos, in which Gregg repre-
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sented that the conversion was complete and that the condos could be
sold.227 But the conversion was held up by the local government be-
cause the government considered the conversion incomplete, and the
buyers sued JMK for fraud.228 JMK, in turn, sued Gregg for contribu-
tion and indemnity.229

The 14th denied Gregg summary judgment on the fraud claim, leav-
ing him open to a jury finding that he committed the tort.230 The 14th
also denied Gregg summary judgment on JMK’s claims for contribu-
tion and indemnity.231 For contribution, the 14th held that “both a
principal and an agent can be held liable for their participation in tor-
tious activity.”232 For both contribution and indemnity, the court
noted that Gregg’s conduct could render his principal vicariously liable.233

These are just the kind of claims superseded by the 14th’s reading of
Section 21.223. The claims of fraud relate to or arise out of a contract
of the corporation, both the sale of the condos to the plaintiffs and
JMK’s retention of Gregg as its attorney. The allegation in J.M.K. 6
was fraud in the inducement of a contract, just as in Hong.234 Under
the 14th’s reading of the statute, Gregg was therefore not “liable to
the corporation or its obligees.”235 Gregg was arguably an “affiliate”
because as an agent of the corporation he was subject to its control.236
Gregg could thus render his employer subject to participatory or vica-
rious liability, but the corporation could never collect from the person
whose misrepresentations caused it liability.

In this way, the 14th’s reading of the statute limits the rights of busi-
nesses to obtain a recovery from the very person who caused them a
loss. Instead, the effect of the statute is to make the employer the
ultimate insurer of losses caused by employee fraud. I think it doubt-
ful that the Texas Legislature meant by this obscure language in a veil-
piercing statute to impose such a shift in loss risk onto corporations
and limited liability companies, yet that is the result of the expansion
the 14th claims.

227. Id.
228. Id. at 192.
229. Id. at 193.
230. See id. at 203–04.
231. Id. at 202–04.
232. Id. at 203.
233. Id. at 202–04.
234. See Hong v. Havey, 551 S.W.3d 875, 889 (Tex. App.—Houston [14th Dist.]
2018, no pet.).
235. TEX. BUS. ORGS. CODE ANN. § 21.223(a) (West 2019).
236. J.M.K. 6, 192 S.W.3d at 204 (“Gregg has neither asserted nor attempted to
prove that its alleged representations fell outside Gregg’s role as J.M.K.’s agent or the
scope of Gregg’s authority.”).
4. Employee Exemption from Fraud, or Immunity for the Price of a Share

Another direct result of the 14th’s reading is to greatly expand the number and kind of persons protected by the statute from fraud liability.

When the statute is limited to its historical purpose, namely, limiting and defining derivative liability under the veil-piercing theories the statute lists, the number of persons protected by subsection (a)(2) is naturally small. As noted in Part III.A,237 the veil-piercing theories referred to in (a)(2) require generally that the corporation be abused in some way—that “the corporate form has been used as part of a basically unfair device to achieve an inequitable result.”238 Only a corporate actor with control of the corporation could achieve this abuse. A controlling shareholder certainly could, as could a dominant director or officer (affiliates, both). Even a non-director manager whose superiors in the corporate structure gave her free rein could abuse the corporation in this manner (also an affiliate). But the veil-piercing theories named in Section 21.223 placed a legal limit on who could be sued for the corporation’s obligations, whether in contract or tort, as specified in Section 21.223.

The theories were not facially limited to shareholders, directors, or officers, so it makes sense for a statute limiting such derivative liability to reach out and, in a slightly overbroad manner, sweep up in its description of who is protected anyone who might be in a position to control. Thus, all shareholders are included,239 as are (as “affiliates”) others—directors, officers, non-officer managers—who might control the corporation. The statute also includes those who might be controlled by the corporation such as subsidiaries likely to be included in the kind of “joint enterprise” theory raised in SSP Partners.240 In a veil-piercing statute, the kinds of actors included in Section 21.223’s protections make perfect sense. So long as a veil-piercing theory was required to be proved as part of producing liability under subsection (a)(2) and subsection (b) (which requires that the corporate actor “caused the corporation to be used for the purpose of perpetrating

237. See supra text accompanying notes 61–64 and accompanying text.


239. The inclusion of shareholders in the protection of the statute is also driven by the legislature’s choice in 1989, when the corporate code was first amended to address veil-piercing, to place the limitation on veil-piercing in a statute about liability for share subscriptions rather than craft a new statute. See Tex. Bus. Corp. Act, 54th Leg., R.S., ch. 64, art. 2.21, 1955 Tex. Gen. Laws 239, 252 (amended 1989) (expired Jan. 1, 2010), https://lrl.texas.gov/LASDOCS/71R/SB1427/SB1427_71R.pdf#page=1 [https://perma.cc/54L8-R6PH]. The language in the preamble of subsection (a) thus must cover (a)(1) as well as (a)(2).

240. SSP Partners, 275 S.W.3d at 454–56.
fraud\(^{241}\), the kind of actors who were protected by the statute was legally limited to those who could be derivatively liable under a veil-piercing theory—necessarily only those with control (or those controlled by those who have control, as a subsidiary might be).

But the 14th’s theory steps around all that. Under the 14th’s theory, subsection (a)(2) addresses the personal liability of the corporate actor for her own torts. She does not need to control the corporation or be controlled by it pursuant to a veil-piercing theory if the 14th is correct, so under the 14th’s view the statute expands from protecting corporate actors in control to anyone in the categories of actors named. Who is this? For starters, under this broadened protection, employees and all agents of the corporation appear to be included. This is so because the test for agency requires that the principal and agent agree that the agent will be subject to the principal’s control.\(^{242}\) All agents then, when acting as such, are affiliates. This would not matter under the common understanding of the statute because veil-piercing liability would never reach all common agents. But under the 14th’s theory, the statute expands from protecting corporate actors with control to protecting anyone with the status of agent. The employees and the corporation’s accountant and lawyer appear to be covered.

The effect of the 14th’s theory also renders the statute’s protections for sale. Again, because veil-piercing theories could only be brought against persons with control, the statute’s reliance on those theories puts a natural limit on who was protected—only those who exercise such control. Control is something one exercises. But under the 14th’s theory, the statute protects every covered person against personal liability for fraud. No control is required. So now the statute protects all shareholders. Even if for some reason a court unduly restricted the plain meaning of “affiliate” so that it did not include employees, selling each employee a share would provide the same protection. That is cheap insurance! Of course, it is not clear that a corporation would want all of its employees covered, as that might also protect them against liability to the corporation for fraud when the corporation was the victim.\(^{243}\) but with share ownership the corporation could pick and choose.

\(^{241}\) TEX. BUS. ORGS. CODE ANN. § 21.223(b) (West 2019).

\(^{242}\) Jody James Farms, JV v. Altman Grp., Inc., 547 S.W.3d 624, 635 (Tex. 2018); Cmty. Health Sys. Prof’l Servs. Corp. v. Hansen, 525 S.W.3d 671, 697 (Tex. 2017) (“To establish an agency relationship, one must show a manifestation of consent by the purported agent to act on the principal’s behalf and subject to the principal’s control, together with a manifestation of consent by the purported principal authorizing his agent to act.”).

\(^{243}\) One might argue that “affiliate” status would cease when the employee committed fraud against the corporation, but the definition depends on control, not interest. Even if this could occur, the statute’s protection would continue for a corporate shareholder whether or not she is an affiliate.
It seems unlikely that the legislature meant the statute to protect all managers and employees against liability for the personal torts they commit, even on behalf of the business, let alone against the business.\textsuperscript{244} It seems unlikely also that, in lieu of employee status, a person could buy fraud immunity for personally committed torts for the price of a share of stock—especially fraud immunity from the corporation whose stock she purchased. The legislature is unlikely to grant for the price of a share a personal immunity from tort law for fraud a person commits.

5. Dis the Partnership

Under the 14th’s reading of Section 21.223, the corporation and the limited liability company carry with them a significant exemption from personal liability for fraud. Because the statute only applies to corporations and limited liability companies, the effect of the 14th’s reading is that these business entities now come with a benefit that other entities with limited liability, such as the limited liability partnership or limited partnership, do not.

Under the common understanding of the statute, this effect was not possible. Limited partnerships are considered in some ways aggregates, not separate, stand-alone entities like corporations.\textsuperscript{245} Because they are not separate entities, their general partners are liable for the contractual and tort liability of the partnership.\textsuperscript{246} Because another method of imposing entity liability on owners existed, courts declined to impose veil-piercing doctrines on limited partnerships.\textsuperscript{247} There was therefore no need to protect partnership actors from veil-piercing liability, and Section 21.223 was naturally written only in the corporate code and extended only otherwise to limited liability companies.

But partnerships, including limited partnerships, can now opt to be treated in effect as separate entities with limited liability,\textsuperscript{248} and the

\begin{footnotesize}
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\textsuperscript{244} See supra note 243.
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\textsuperscript{245} A limited partnership is governed as a partnership to the extent partnership law is not displaced by specific provision of the limited partnership code. \textit{Tex. Bus. Orgs. Code Ann.} § 153.003 (West 2006). General partners are thus treated much like partners in a general partnership. For such general partners, legal title to partnership property may be held in the name of a partner. \textit{Id.} § 152.102(a)(2). Each “partner is an agent of the partnership for purpose of its business,” \textit{id.} § 152.301, and “all partners are jointly and severally liable for all obligations of the partnership” by default. \textit{Id.} § 152.304. The aggregate nature of partnership rules is strong enough that the code drafters felt a need to reverse it as a general default. See \textit{id.} § 152.056 (“A partnership is an entity distinct from its partners.”).
\footnotesize
\textsuperscript{246} See \textit{id.} § 152.302–.304.
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code now declares that they are such.\textsuperscript{249} The law is clearly moving in the direction of contractual freedom in entity choice.

The 14th’s decisions step backward, however. The 14th has declared that a statute only covering actors in the corporate and limited liability context have a personal exemption from liability for fraud that they themselves commit. This is a significant economic benefit to corporate actors, especially small business actors who may well be able to abandon the entity and ensure that their fraud victims never recover. Because this limitation on tort law extends far beyond veil-piercing, it would be equally beneficial, and could apply equally, to partners in limited liability partnerships. But it does not—primarily because it is buried in a statute on veil-piercing in language that reaches the 14th’s result only when part of the statute is ignored. What the 14th imagines is a step forward for corporations and limited liability companies is a step backward in the TBOC’s movement to harmonize limited liability entities. This also suggests that the 14th’s result is not what the legislature intended.

D. No Way to Contract Around

How would one contract around the 14th’s rule? There is no way to do it, I think. One makes contracts with the entity, not the employees or shareholders. The employees are not going to sign an agreement waiving their immunity from fraud in favor of a counterparty of their employer. However, counterparties should seek such things under the 14th’s rule.

Employers, on the other hand, should immediately begin asking employees to waive their immunity under Section 21.223. Employees should not do so, but the necessity that their employers ask them to is also an effect of the 14th’s theory.

V. Justification

A. An Exemption from Tort Law

Beyond all of these things, the 14th’s result is hard to rationalize. What justifies a legislative exemption from direct and personal tort liability for fraud committed by the owners and controllers of, and those controlled by, corporations and LLCs?

This is difficult to imagine. Trust makes a market possible and successful; it makes freedom of contract possible. The “rules of the game” in a free economy require that businesses make profits “without deception or fraud.”\textsuperscript{250} And “the role of government . . . is to do some-

\textsuperscript{249}. Id. §§ 1.002(22), 152.056.
\textsuperscript{250}. Milton Friedman, Capitalism and Freedom 133 (40th Anniversary ed. 2002).
thing that the market cannot do for itself, namely, to . . . enforce the rules of the game.”

Contractual freedom depends on legal protection against fraud:

The case in favor of freedom rests on the postulate of mutual gains through trade. The rationale for this institution provides the essential clue for its limitation. When bargaining takes place in settings where mutual gain is not the probable outcome, there is sufficient warrant for the law to step in to set that transaction aside. Transactions will never go forward when both sides expect to lose; consequently the greatest danger lurks when one side to the bargain is made better off by an exchange that is likely to make the other side worse off.

The dangers of fraud, or indeed any misrepresentation, . . . can arise in any transaction. If goods worth $10 are represented by the seller as being worth $12, then the buyer who pays $11 ends up worse off for having traded under false information. Misrepresentation blocks the mutual gain, and is all the more likely to occur when deceit is practiced.

[Thus,] with respect to the intentional infliction of harm, the conclusion is too clear to require extended discussion. If harms may be routinely inflicted on purpose, the rules of protection are gutted from the outset, and autonomy and property quickly tumble.

For these reasons, “[n]o one doubts” that the fraud victim “has her action” against the deceiver “for fraud”—until now, anyway, when the 14th has declared an exemption from hundreds of years of tort law wisdom.

Fraud is, as Posner wrote, “not a conflict between legitimate (productive) activities but a coerced transfer of wealth to the defendant in a setting of low transaction costs.” Why would the legislature legalize it? “[I]f such transfers were permitted, owners would spend heavily on protection and thieves would spend heavily on thwarting the owners’ protective efforts. Their joint expenditures would be wasted from a social standpoint; this waste is the economic objection to theft.”

251. Id. at 27.
253. Id. at 81. Epstein further argues, “[O]nly the committed opponents of laissez faire are bold enough to claim that the principal of freedom of contract is so absolute that this class of defenses is excluded. The sensible advocates of laissez faire all recognize that the power of contract lives and dies with the presupposition of mutual gain for self-interested parties on which it rests . . . .

Id. at 82.
254. Id. at 92.
255. Id. at 195.
256. Richard A. Posner, Economic Analysis of Law 205 (7th ed. 2007). “The liar makes a positive investment in manufacturing and disseminating misinformation. This investment is wasted from a social standpoint . . . .” Id. at 111.
257. Id. at 205.
Fraud prevention, like theft prevention, is a core function of government.

And it is not as if the protections left in place are going to discourage fraud enough. The level of criminal prosecution for fraud in Houston is not nearly sufficient to make up for the loss of tort law protections. Even if it were, criminal prosecution is hardly compensatory in a manner necessary to discourage fraud and encourage freedom of contract in the way tort law provides.

Tort law provides optimal disincentive for fraud by providing damages for fraud and holding out the real possibility of punitive damages. Such damages are necessary to maintain freedom of contract. A consideration of losses in case of fraud shows this to be the case.

For instance, suppose the law provided no tort liability, as the 14th's theory allows. Then the fraud victim is left with, at best, rescission of a contract, and at worst, nothing at all. If the law provides only that fraud grants rescission of a contract, then the fraud victim must pay the transaction costs to rescind and can only obtain back the value taken by fraud. If that were all the law provided, then the fraud victim has lost the costs of rescission and missed out on lost opportunities, but the fraudster is out nothing. Given that not all fraud victims will rescind, such a regime would make fraud pay; the defrauder's lack of real loss would make tricking people out of their property profitable.

The situation is not helped much if fraud is remedied merely by requiring the defrauder to pay the fraud victim the true cost of the exchange. This is an improvement, but the fraud victim must still pay the costs of enforcement. Moreover, the fraud victim is tricked into the transaction in the first place and so has been deprived of the process of contracting with an honest counterparty, and the value of this lost opportunity is economic waste. Even more importantly, the defrauder has managed to keep what it bargained for in the transaction. The defrauder has through the fraud forced a transfer of property that would not have happened without the fraud; in this way, fraud remains equivalent to theft. And given that not all fraud victims will notice the fraud and take the initiative to sue for damages, the defrauder might across a number of similar transactions benefit from the fraud enough to make it pay even more.

The only way to ensure that the intentional defrauder does not take more from the transaction than the victim suffers is to grant damages in addition to the value of the thing traded had it been as represented. This is often the role that punitive damages play in a fraud case.

For all these reasons, granting an exemption from tort liability for fraud discourages freedom of contract.


B. An Unequal Exemption

The statute as framed by the 14th also renders the law oddly unequal without any supporting rationale. Sole proprietors, partners (even partners of a limited liability partnership), non-profit entities, and employees of these all remain liable for the fraud they commit. The parties defrauded by those persons whom the 14th claims are protected by the statute would themselves be personally liable for the fraud they commit against the persons protected by the statute. In fact, everyone who commits fraud is liable for the tort—except the corporate actors named in Section 21.223, according to the 14th Court of Appeals. This inequality of treatment cries out for a policy justification, not just a reference to a relatively obscure veil-piercing statute.

I cannot think what justification could exist. The economic circumstances of the corporate actors supposedly protected by the 14th’s decisions are not different in any relevant way from the economic circumstances of hundreds of thousands of other economic actors. The difference is especially stark for the non-controlling shareholder, the one who has no say in the business. This person bought a share and now can lie to contract counterparties with impunity. Or consider the common employee, assuming such is an “affiliate.” What makes the corporate employee different from the employee of any other business? Why should these be exempt from personal responsibility for the lies they tell, harming common trust and contractual freedom, when every other economic actor is—quite rightly—made to pay the harm caused by their intentional lies?

C. What the Commentators Say

The few commentators who have argued for the 14th’s result do not suggest much in the way of rationale.

Glenn West suggests that corporate actors, especially agents, are liable for the torts they commit within the scope of their agency only because of their agency: “The second exception to the general rule of agent non-liability is that an agent will be personally liable for torts individually committed by that agent, even if she commits those torts solely within the scope of her agency.”260 In this statement, West reduces the ground of liability to the wrong source, as explained above in Part IV.A.2.261 Each person subject to the law has a duty not to intentionally harm another person. Tortfeasors are liable because they commit torts. That the principal is also liable is an add-on from

260. West & Nelson, supra note 151, at 804; see also West & Treadway, supra note 151, at 811–12 (“[I]t is a settled principle of agency law that the agent can be liable for his or her own torts even when acting within the scope . . . .”).

261. See supra notes 135–146 and accompanying text.
agency law. That the agent remains liable is not a result of agency law. It is the result of tort law.

Without acknowledging this, West claims there is a difference:

In torts unrelated to the negotiation of freely bargained contracts, the authors acknowledge that there are sound policy reasons for holding agents personally liable for intentional torts in the services of their corporate principals. Certainly the defense of “I was only following orders” should never be countenanced in such circumstances. The authors believe, however, that torts arising from contractual arrangements are fundamentally different . . . .

But West never says how they are fundamentally different. Could they be? I cannot think why. They are the economic equivalent of theft.

What West is worried about is probably revealed in an earlier comment. After noting that corporate actors normally are personally liable for the torts they commit, West complains,

However, when a corporate officer acting on behalf of his or her corporate employer in connection with a transaction is personally sued for fraud, violations of the Deceptive Trade Practices Act, negligent misrepresentation, tortious interference with contract or similar torts arising out of contractual negotiation, there is an immediate reaction by the corporate lawyer that the officer cannot possibly be personally liable because, after all, he or she is acting solely on behalf of the corporation.

I assume that West is not advocating that corporate actors should be able to commit fraud with impunity on behalf of their businesses. Probably, West’s gripe is that too many business actors are caught up in corporate litigation without good reason. Plaintiffs’ attorneys raise personal claims against corporate actors for tactical reasons, and without a clear basis in fact, with the result that contract litigation has an unwarranted and more serious impact on corporate actors than it should. If this is what West means, we might all sympathize.

262. Agency law leaves the effects of tort law in place. See, e.g., Restatement (Third) of Agency § 7.01 (Am. Law Inst. 2006). This is probably what West had in mind. Agency law attributes the ground of that liability to tort, however. See id. cmt. b (“The justification for this basic rule is that a person is responsible for the legal consequences of torts committed by that person. A tort committed by an agent constitutes a wrong to the tort victim independently of the capacity in which the agent committed the tort. The injury suffered by the victim of a tort is the same regardless of whether the tortfeasor acted independently or happened to be acting as an agent or employee of another person.”).

263. West & Nelson, supra note 151, at 805 n.32.

264. West & Treadway, supra note 151, at 812.

265. This appears to be the rationale of Chamberlain and DeLeon, also. See Chamberlain & DeLeon, supra note 136, at 1 (“There are reasons for a Plaintiff to pursue a corporate or limited liability company (LLC) officer or owner/member individually—personal vendetta, the corporation may be insolvent, or the Plaintiff doesn’t want the company to suffer for what they view as the responsibility of the officer or owner.”). The authors miss the point that individuals should be held liable for the wrongs they intentionally commit. They seem to have forgotten that tort law quite rightly requires
one wants to be personally in someone’s crosshairs, especially if they really were acting innocently and only in an agent role and not for themselves.

But it should be obvious that overclaiming by plaintiffs’ attorneys does not justify an exemption from tort law for a large class of business actors. If fraud is too easy to allege, make it harder to allege. If fraud is too easy to prove, make it harder to prove. Note also that principals owe their agents a duty of indemnity for false accusations of tort that are leveled against them for their actions as agents,267 and this indemnity obligation includes a duty to defend.268 Perhaps the obligation to indemnify and defend needs to be strengthened. Exempting corporate actors from personal responsibility entirely, merely because allegations are too easily made, is not good governance. Allegations of child and spouse abuse are also too easily made, and a simple fix would be to exempt from liability the actions of men toward their wives and children. But that is not a good solution because abuse personal responsibility for harm done to others. They warn against conflating the owners and the entity, yet this appears to be exactly what they have done. Id. They also use the phrase “corporate shield” as if it meant something far more than that the corporation is a separate entity, as if creating a corporation somehow changed one’s relationship to other people. Id. at 1, 3, 6, 10.

266. The El Paso case, Valley Forge Motor Co. v. Sifuentes, 595 S.W.3d 871 (Tex. App.—El Paso 2020, no pet.), involved a claim against Ruben Sifuentes, who represented himself on appeal. One sympathizes with Mr. Sifuentes, who repaired a Mustang for Hill before finding out Hill did not own the vehicle. Id. at 873. Mr. Sifuentes tried to obtain payment for his work by filing a mechanics lien on the car and then foreclosing on the lien. Id. at 873–74. This is hardly the stuff of fraud. Why do the trial courts allow such fluffy charges? Fixing fraud law is where the courts should spend their efforts. Mr. Sifuentes was likely not a party to any contract. Rather than deal with the claims on the merits, the court declared Mr. Sifuentes was “shielded” from liability for the fraud and other claims. Id. at 876, 878. Incidentally, the El Paso court quite recently did not see Section 21.223 as relevant. See Chico Auto Parts & Serv., Inc. v. Crockett, 512 S.W.3d 560, 570–75 & nn. 6–7 (Tex. App.—El Paso 2017, pet. denied) (reviewing the statute at length but concluding, “a plaintiff may sue a corporation’s affiliate for his torts, including fraud, without the need to pierce the corporate veil”).

267. See, e.g., Oats v. Dublin Nat’l Bank, 90 S.W.2d 824, 829 (Tex. 1936) (“the established rule that a principal is bound to indemnify his agent for loss resulting proximately from the good faith execution of the agency”); e.g., Bellefonte Underwriters Ins. Co. v. Brown, 663 S.W.2d 562, 572 (Tex. App.—Houston [14th Dist.] 1983), aff’d in part, rev’d in part on other grounds, 704 S.W.2d 742 (Tex. 1986); RESTATEMENT (THIRD) OF AGENCY § 8.14 & cmts. b, d (AM. LAW INST. 2006) (“In the absence of an express contractual provision that requires the principal to indemnify an agent in connection with litigation against the agent, a principal has a duty to indemnify the agent against expenses and other losses incurred by the agent in defending against actions brought by third parties if the agent acted with actual authority in taking the action challenged by the third party’s suit.”). But see Godwin v. Jessell, No. 05-99-01824-CV, 2001 WL 111558 (Tex. App.—Dallas Feb. 9, 2001, no pet.) (rejecting a right of indemnity as contrary to the state’s proportionate responsibility statute).

268. See RESTATEMENT (THIRD) OF AGENCY § 8.14 & cmt. d (AM. LAW INST. 2006) (“An agent seeking indemnification has a prior duty to give timely notice to the principal of the third party’s suit so that the principal may provide the agent with a defense.”).
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actually occurs and its commission is too serious to exempt from liability. The same is true of fraud.

How does one explain the difference in the law’s treatment of contracts and torts? Any number of authorities explain the rule, and we have named many of them earlier in Part IV.A.2. Leitch v. Hornsby,269 indicated that whether the agent owed an independent duty would control the issue. The Supreme Court of Texas later clarified, “[T]he legal duty not to fraudulently procure a contract is separate and independent from the duties established by the contract itself.”270 Leitch cited the Restatement (Second) of Agency, which holds, “An agent who does an act otherwise a tort is not relieved from liability by the fact that he acted at the command of the principal or on account of the principal . . . .”271 Note the language: “an agent . . . is not relieved.”272 That is the key. Agency law does not relieve an agent from liability that the agent already has under tort law.

A corporation has power to “make contracts.”273 A corporation does this when it authorizes its agent to make a contract on its behalf. When an agent discloses the existence and identity of its principal and acts only on the principal’s behalf in forming a contract, the principal and not the agent is liable.274 This rule of agency law is exactly what one would also expect from contract law. Because contractual liability arises from promising—from some agreement to take some future action—it is absent for the agent when the agent acts merely as an agent on behalf of a disclosed and identified principal. No one would think that the agent had promised.

Fraud is quite a different matter. Liability for fraud arises from making a misrepresentation.275 Anyone whose conduct meets the elements of the tort has committed fraud.276 Agency law does not relieve defrauders of liability merely because, in addition to committing

270. Formosa Plastics Corp. USA v. Presidio Eng’rs & Contractors, Inc., 960 S.W.2d 41, 46–47 (Tex. 1998) (“[A]n independent legal duty, separate from the existence of the contract itself, precludes the use of fraud to induce a binding agreement.”) (holding that the economic loss rule does not preclude a fraudulent inducement claim).
272. Id.
274. E.g., Eppler, Guerin & Turner, Inc. v. Kasmir, 685 S.W.2d 737 (Tex. App.—Dallas 1985, writ ref’d n.r.e.).
275. Anderson v. Durant, 550 S.W.3d 605, 614 (Tex. 2018) (“Texas has long imposed a duty to abstain from inducing another to enter into a contract through the use of fraudulent misrepresentations.”). Incidentally, in Anderson, Durant was personally liable for the fraudulent inducement that his businesses also committed. Id. at 610, 613–17 (identifying Durant as the majority shareholder of Jerry Durant Auto Group, Inc., which was found liable for fraud (along with two subsidiary corporations) for the same false promise for which Jerry Durant was found liable). Under the 14th’s holding, such a result would be impossible.
276. See id. at 614.
fraud, they were also working for someone at the time, or even committed fraud on behalf of another. The elements of fraud are not different for employees, and “was not working for someone else at the time” is not an element of fraud. This makes perfect sense. The duty not to lie, cheat, and steal is a duty of our common humanity, enforced by courts in the interest of civilization and economic cooperation. One should not get a pass from such duties merely because one was working for someone else at the time.277

VI. CONCLUSION

We have come a long way. In 1993, a federal judge in east Texas was asked to apply the law of Kazakhstan to a case involving Kazakhs and Texans.278 Kazakh law was argued because “the law of Republic of Kazakhstan precludes recovery against employee tortfeasors acting within the course and scope of their employment.”279 The law reflected “a Kazakhi desire that all damage inflicted by employees should be borne by the organization that employs them . . . . [T]he organization can then seek indemnity from the employee but only in limited amounts per month or in other special situations.”280 The Kazakh law probably originated in the Soviet Civil Code.281 The Kazakh law socialized the cost of fraud within the business and refused to impose personal responsibility for fraud on those who commit it.

The district court resisted the application of Kazakh law in part because Texans believe in personal responsibility:

In contrast, Texas has a strong interest in ensuring that its residents do not perpetuate [perpetrate?] fraud on its own residents or anyone else. To further that interest, Texas has chosen not to insulate its residents from liability. To do otherwise would enable Texas residents to hide behind the corporate veil and discourage responsible individual behavior.282

Is this no longer true? In Kazakh law, at least the corporation might hold the defrauder liable, ultimately. Even that possibility of personal responsibility disappears under the 14th’s reading of Section 21.223.

The statute is just a veil-piercing regulation:

The statute requires that liability limited by it be “on the basis of” a veil-piercing theory—one of those named or an “other similar the-

277. As the Supreme Court of Texas said in a related context, “If that were the case, a party could avoid tort liability to the world simply by entering into a contract with one party.” Sharyland Water Supply Corp. v. City of Alton, 354 S.W.3d 407, 419 (Tex. 2011).
279. Id.
280. Id. at 1350.
281. Id.
282. Id. at 1351.
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The common law tort of fraud is not included. The context of both Section 21.223 in the corporate code and subsections (a)(2) and (b) within that Section strongly suggest that no exemption from tort law was intended.

The legislative history strongly supports the statute’s veil-piercing purpose. Nothing in that legislative history suggests anything else.

The results of reading the statute as does the 14th suggest that the Texas Legislature intended no such reading. Such results include:

- the probability that the 14th’s expanded reading will leave some fraud unremedied and thus encourage business actors to game the system to take advantage of a personal exemption;
- that fraud is exempted, but not negligence or other less serious torts;
- that covered corporate actors are exempt from liability for defrauding their own corporations, and also exempt from indemnity and contribution;
- that an exemption from tort law, for those who want it, becomes available for the price of a share; and
- that the exemption is provided so unevenly among business actors and entities.

That no good way exists to contract around the 14th’s results not only suggests that the legislature did not intend this reading but also shows that this reading presents an obstacle to contractual freedom. This rule will be especially hard on smaller businesses. Who would hire TecLogistics, Inc., now? Dresser-Rand would be much better off hiring a larger company that would be good for its employees’ fraudulent acts and is not controlled by a single individual from whom Dresser-Rand should extract a waiver of Section 21.223 immunity before doing business.

The lack of any good rationale in support also suggests that the legislature did not intend this result.

The lack of a rationale, the removal of a disincentive to commit fraud, and the possibility of unremedied fraud in Texas also suggest that this new position will decrease trust, increase the cost of doing business, and make true contractual freedom less likely and less common. The exemption also breaches the law’s obligation to hold economic actors to the “rules of the game” necessary for economic flourishing.

Some feel that fraud is alleged too easily and too often. Surely it is alleged sometimes without merit, and litigating it is costly. Sorting meritorious claims from unmeritorious claims is the role of courts,

however, both the judge and the jury. Closing the courts to fraud claims to save the cost of litigating those that are meritless surely would cost Texas far too much.