

**OWNER LIABILITY PROTECTION
AND PIERCING THE VEIL OF
TEXAS BUSINESS ENTITIES**

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CHAPTER 5

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I. Introduction

Sole proprietors and partners in a traditional general partnership enjoy no protection from the debts and liabilities of the business. The various business entities that provide some type of liability protection¹ do so under slightly varying approaches. These variations are discussed below. The concept of “piercing the corporate veil” is fairly well-developed; piercing in the context of alternative entities is not as well-developed. The law in this regard is also discussed below.

II. Corporations

A. Limited Liability of Shareholders

A corporation is well-recognized for its complete liability shield. Unless a shareholder, director, or officer is liable on some independent legal basis (e.g., is personally a tortfeasor or guarantor), such parties have no liability for corporate debts and obligations. Of course, the courts have allowed plaintiffs in exceptional circumstances to “pierce the corporate veil.”

B. Piercing the Corporate Veil

A short discussion cannot do justice to the developments in the area of corporate veil piercing in Texas over the last 20 years; however, a brief summary is provided below.

1. Alter Ego Theory

Traditionally, most veil piercing cases were premised on the alter ego theory. The Texas Supreme Court has described this basis for piercing the corporate veil as follows: “Under the alter ego theory, courts disregard the corporate entity when there exists such unity between the corporation and individual that the corporation ceases to be separate and when holding only

the corporation liable would promote injustice.” *Mancorp, Inc. v. Culpepper*, 802 S.W.2d 226, 228 (Tex. 1990). The total dealings between the shareholder and the corporation are relevant in determining whether there is an alter ego relationship. *Id.*; see also *Gentry v. Credit Plan Corp. of Houston*, 528 S.W.2d 571 (Tex. 1975). The supreme court has stated that the evidence may include “the degree to which corporate formalities have been followed and corporate and individual property have been kept separately, the amount of financial interest, ownership and control the individual maintains over the corporation, and whether the corporation has been used for personal purposes.” *Mancorp, Inc. v. Culpepper*, 802 S.W.2d at 228, citing *Castleberry v. Branscum*, 721 S.W.2d 279, 272 (Tex. 1986). The alter ego theory has been affected by legislative developments described below. In a case in which a claimant seeks to impose liability on a shareholder for a corporate obligation arising out of a contract, the claimant must meet the actual fraud standard described below. Additionally, as discussed below, the role of corporate formalities in a veil piercing analysis is now addressed by statute.

2. The Emergence of “Sham to Perpetrate a Fraud” and the Legislative Response (Statutory Actual Fraud Requirement in Cases Arising Out of a Contract)

The Texas Supreme Court articulated what many believed was an unprecedented and unduly broad approach to veil piercing in *Castleberry v. Branscum*, 721 S.W.2d 270 (1986). In that case, the court recognized the “sham to perpetrate a fraud” basis for piercing the corporate veil. This theory was distinct from alter ego, explained the court, and was a basis to pierce the corporate veil if “recognizing the separate corporate existence would bring about an inequitable result.” To prove there has been a sham to perpetrate a fraud, the court stated that tort claimants or contract creditors need only show constructive fraud. The court described constructive fraud as “the breach of some legal or equitable duty which, irrespective of moral guilt, the law declares fraudulent because of its tendency to deceive others, to violate confidence, or to injure public interests.”

The Texas legislature reacted to the *Castleberry* opinion by amending the Texas Business Corporation Act (the “TBCA”). As a result, veil piercing is now addressed by statute in Texas in such a way that piercing the corporate veil to impose personal liability for a contractual, or contractually-related, obligation of a corporation is quite difficult. The TBCA provides that a shareholder or affiliate may not be held liable for a contractual obligation of the corporation, or any matter

¹The forms of business entity discussed in this paper are the corporation, limited liability company, limited partnership, and limited liability partnership. The current statutes governing such entities in Texas are the Texas Business Organizations Code, the Texas Business Corporation Act, the Texas Limited Liability Company Act, the Texas Revised Limited Partnership Act, and the Texas Revised Partnership Act. The Texas Business Organizations Code became effective January 1, 2006, and governs business entities formed on or after that date. A domestic entity formed before January 1, 2006 will continue to be governed by the pre-Code statutes governing that type of entity until January 1, 2010, unless the entity voluntarily elects to adopt the Business Organizations Code prior to 2010. Effective January 1, 2010, the current business entity statutes will expire, and the Business Organizations Code will govern all domestic entities.

relating to or arising from the contractual obligation, unless the shareholder or affiliate used the corporation to perpetrate an actual fraud for the direct personal benefit of the shareholder or affiliate. Tex. Bus. Corp. Act art. 2.21A(2). This provision has been carried forward in the corporate provisions of the Business Organizations Code (the “BOC”). Bus. Org. Code § 21.223(a)(2) and (b).

A 1998 court of appeals case illustrates the difficulty plaintiffs may have in meeting these standards to pierce the veil. In *Menetti v. Chavers*, 974 S.W.2d 168 (Tex.App.–San Antonio 1998, no pet.), the plaintiffs sued their builder alleging breach of contract and various tort and DTPA claims. The court determined that all the claims arose from or related to the construction contract and required a showing of actual fraud to pierce the corporate veil. The court acknowledged that the evidence indicated the defendants were poor bookkeepers and took little effort to preserve the corporate fiction; however, there was no evidence that the defendants made any fraudulent misrepresentations (the theory of actual fraud pursued by the plaintiffs). Thus, the plaintiffs were unable to impose liability based upon the alter ego theory. In addition, the court held that, since Article 2.21 requires actual fraud to pierce the veil on the basis of “alter ego, ... sham to perpetrate a fraud, or other similar theory,” the lack of actual fraud precluded liability under all of the other theories pleaded by the plaintiffs, including sham to perpetrate a fraud, denuding, trust fund doctrine, and illegal purposes.

The Texas Supreme Court recently discussed the “narrowly prescribed...circumstances under which a shareholder can be held liable for corporate debts” under TBCA Article 2.21 and BOC Sections 21.223–21.226. *Willis v. Donnelly*, 199 S.W.3d 262, 271–73 (Tex. 2006). Donnelly argued that Willis and his wife were personally liable for the breach of a letter agreement under which two corporations formed by Willis were obligated to issue stock to Donnelly. After describing the circumstances leading to the amendment of Article 2.21 (i.e., the business community’s displeasure with the flexible approach to veil piercing embraced in *Castleberry*), the court relied upon BOC Sections 21.224–21.225 to reject Donnelly’s claim that the Willises were liable for breach of the agreement based on an implied ratification of the agreement. The court pointed out that the statute precludes holding a shareholder liable for any contractual obligation of the corporation on the basis of alter ego, actual or constructive fraud, sham to perpetrate a fraud, or *other similar theory* unless the shareholder causes the corporation to be used to perpetrate an actual fraud on the obligee for the shareholder’s direct personal benefit or the shareholder expressly agrees to be personally liable for the obligation. The jury rejected Donnelly’s

fraud claim, and the court concluded that the Willises did not expressly agree to assume personal liability under the contract. According to the court, “[t]o impose liability against the Willises under a common law theory of implied ratification because they accepted the benefits of the letter agreement would contravene the statutory imperative that, absent actual fraud or an express agreement to assume personal liability, a shareholder may not be held liable for contractual obligations of the corporation.” The court held that Donnelly’s characterization of his theory as “ratification” rather than “alter ego” was simply asserting another “similar theory” of derivative liability that is covered by the statute.

TBCA Article 2.21 and BOC Section 21.223 do not specify that liability based upon alter ego, sham to perpetrate a fraud, or other veil piercing theories must be accompanied by actual fraud if the underlying claim is based upon a tort or statutory liability that does not arise out of a contract of the corporation. See *Love v. State*, 972 S.W.2d 114, 117–18 (Tex.App.–Austin 1998, pet. denied); *Farr v. Sun World Savings Ass’n*, 810 S.W.2d 294, 296 (Tex.App.–El Paso 1991, no writ); *Western Horizontal Drilling, Inc. v. Jonnet Energy Corp.*, 11 F.3d 65, 68 n. 4 (5th Cir. 1994); *Nordar Holdings, Inc. v. Western Securities (USA) Ltd.*, 969 F.Supp. 420, 422 and 423 n. 2 (N.D.Tex.1997). Bar committee commentary, however, characterizes the constructive fraud standard as “questionable” in the context of tort claims and suggests that the amendments should be considered by analogy in the context of tort claims, in particular contractually based tort claims. Tex. Bus. Corp. Act art. 2.21, Comment of Bar Committee–1996. The statute was amended in 1997 to make clear that the corporate veil may not be pierced to hold a shareholder or affiliate liable on a claim “relating to or arising from” a contractual obligation of the corporation absent actual fraud on the part of the shareholder or affiliate.

While actual fraud may not be required to pierce the corporate veil in the context of a non-contractual obligation, veil piercing has traditionally been predicated on notions of justice and fairness. Thus, the plaintiff should nevertheless be required to establish that injustice or inequity will result if the separate corporate existence is recognized. See *Matthews Constr. Co., Inc. v. Rosen*, 796 S.W.2d 692 (Tex. 1990) (stating that “[w]hen the corporate form is used as an essentially unfair device – when it is used as a sham – courts may act in equity to disregard the usual rules of law in order to avoid an inequitable result”); *Mancorp, Inc. v. Culpepper*, 802 S.W.2d 226 (Tex. 1990) (stating that courts may disregard the corporate entity under the alter ego theory “when there exists such unity between the corporation and individual that the corporation ceases to

be separate and when holding only the corporation liable would promote injustice”); *Lucas v. Texas Indus., Inc.*, 696 S.W.2d 372 (Tex. 1984) (noting policy reasons that courts are less reluctant to pierce the veil in tort cases than breach of contract cases but refusing to pierce the corporate veil in the tort case in question in the absence of evidence that the corporate form caused the plaintiff to fall victim to a “basically unfair device by which ... [the] corporate entity was used to achieve an inequitable result”).

The statutory actual fraud standard applicable in a veil piercing case does not protect corporate shareholders/officers from liability for their own torts, even though such torts may have occurred while acting on behalf of the corporation in the context of a contractual transaction between the corporation and the plaintiff. *Gore v. Scotland Golf, Inc.*, 136 S.W.3d 26, 32 (Tex.App.–San Antonio 2003, pet. denied); *Kingston v. Helm*, 825 S.W.3d 755, 764-67 (Tex.App.–Corpus Christi 2002, pet. denied); *but see* Glenn D. West and Adam D. Nelson, Corporations, 57 SMU L. REV. 799, 805-08 (2004) (disagreeing with application of agency law to impose liability on corporate officer in *Gore v. Scotland Golf, Inc.*); Glenn D. West and Susan Y. Chao, Corporations, 56 SMU L. REV. 1395, 1403-08 (2003) (disagreeing with application of agency law to impose liability on corporate officer in *Kingston v. Helm*).

3. De-Emphasis of Corporate Formalities

The Texas legislature has addressed the relevance of failure to follow corporate formalities in the veil piercing context. Traditionally, the failure to follow corporate formalities has been a factor in alter ego veil piercing cases. Article 2.21A(3) of the TBCA and Section 21.223(a)(3) of the BOC now provide that failure to follow corporate formalities is not a “basis” to hold a shareholder or affiliate liable for any obligation of the corporation.² Courts have generally interpreted this

²In addition to the veil piercing provisions contained in TBCA Article 2.21 and BOC Section 21.231, which are applicable generally to Texas corporations, there are special provisions in Article 2.30-1 and Part 12 of the TBCA and Subchapter C (Sections 21.101-21.109) and Subchapter O (Sections 21.701-21.732) of Chapter 21 of the BOC. These provisions permit a closely held corporation to operate pursuant to a shareholders’ agreement that dispenses with traditional corporate features if certain requirements are met.

TBCA Article 2.30-1 and BOC Section 21.101 allow shareholders of a closely held corporation to structure the corporation to alter or dispense with traditional corporate rules and norms if certain conditions and requirements set forth in the statute are met. TBCA Article 2.30-1G and BOC Section 21.107 state that the existence or performance of a shareholders’ agreement shall not be grounds for imposing

provision to mean that failure to follow corporate formalities is no longer a “factor” in applying the alter ego theory of veil piercing. *See, e.g., Hoffman v. Dandurand*, 180 S.W.3d 340, 347 (Tex.App.–Dallas 2005, no pet.); *Carone v. Retamco Operating, Inc.*, 138 S.W.3d 1, 13 (Tex.App.–San Antonio 2004, pet. denied); *Hall v. Timmons*, 987 S.W.2d 248, 250 n. 2 (Tex.App.–Beaumont 1999, no pet. hist.); *Hunt v. Stephens*, 2002 WL 32341814 *5 (Tex.App.–Eastland 2002, no pet.) (not designated for publication); *Eckhardt v. Hardeman*, 1999 WL 33226 * 4 n. 4 (Tex.App.–Austin Jan. 28, 1999, pet. denied) (not designated for publication); *see also Mancorp, Inc. v. Culpepper*, 802 S.W.2d 226, 233 (Tex. 1990) (Hecht, J., dissenting); *but see Schlueter v. Carey*, 112 S.W.3d 164, 170 (Tex. App.–Fort Worth 2003, pet. denied) (considering failure to follow corporate formalities along with other evidence of alter ego and interpreting TBCA Article 2.21 as providing individual may not be held liable under alter ego theory “based simply” on corporation’s failure to follow corporate formalities). The suggested instruction for defining the alter ego basis of holding a shareholder liable in *Texas Pattern Jury*

personal liability on a shareholder for the obligations of the corporation by disregarding the separate corporate entity even if, pursuant to the agreement, the corporation operates as if it were a partnership or fails to observe corporate formalities otherwise applicable.

Article 2.30-1 was added to the TBCA in 1997, and its requirements (and those of its successor provisions in BOC Sections 21.101-21.109) are somewhat simpler than those imposed under the Texas Close Corporation Law found at Part 12 of the TBCA and Sections 21.701-21.732 of the BOC. In order to be a “close corporation” governed by the Texas Close Corporation Law, the articles of incorporation or certificate of formation of the corporation must contain the following statement: “This corporation is a close corporation.” Additionally, a close corporation that operates pursuant to a shareholders’ agreement under the Texas Close Corporation Law must file a statement of operation as a close corporation with the Secretary of State. Part 12 of the TBCA and Subchapter O of Chapter 21 of the BOC also contain a provision that protects shareholders of these special statutory “close corporations” against veil piercing. This protective provision states that neither the failure of a close corporation to observe usual formalities or the statutory requirements prescribed for an ordinary corporation, nor the performance of a shareholders’ agreement that treats the close corporation as if it were a partnership or in a manner that otherwise is appropriate only among partners, is a factor in determining whether to impose personal liability on the shareholders for an obligation of the close corporation by disregarding the separate corporate existence or otherwise. Tex. Bus. Corp. Act art. 12.37F; Bus. Org. Code § 21.730.

Charges conspicuously omits any reference to “failure to follow corporate formalities.” See PJC 108.2.

4. The Rise of the Single Business Enterprise Theory

Over the past twenty years, the “single business enterprise” veil piercing theory has emerged in Texas. Under this theory, the assets of affiliates of a corporation may be reached to satisfy the liability of the corporation if the corporation and the affiliates constitute a “single business enterprise.” In *Superior Derrick Services, Inc. v. Anderson*, 831 S.W.2d 868 (Tex.App.—Houston [14th Dist.] 1992, writ denied), the court, in addressing whether the evidence was sufficient to hold one corporation (“Superior”) jointly and severally liable for the debt of another corporation (“Champion”) on the basis that they operated as a single business enterprise, stated:

The “single business enterprise” theory involves corporations that “integrate their resources to achieve a common business purpose....” *Paramount Petroleum Corp. v. Taylor Rental Center*, 712 S.W.2d 534, 536 (Tex.App.—Houston [14th Dist.] 1986, writ ref’d n.r.e.). In determining whether two corporations had not been maintained as separate entities, the court may consider the following factors: (1) common employees; (2) common offices; (3) centralized accounting; (4) payment of wages by one corporation to another corporation’s employees; (5) common business name; (6) services rendered by the employees of one corporation on behalf of another corporation; (7) undocumented transfers of funds between corporations; and (8) unclear allocation of profits and losses between corporations. *Id.*

831 S.W.2d at 874.

Though some of the factors were absent, the court found the evidence sufficient to uphold the finding that the two corporations in question operated as a single business enterprise.

The evidence showed that a Superior stockholder formed Champion, Superior provided office space for Champion in the same building as Superior’s offices, Superior provided

Champion with all forms necessary for business, performed services for Champion, and that Superior paid all of Champion’s bills, expenses, and employee salaries. In our opinion, this is sufficient to show that the two corporations did not operate as “separate entities but rather integrate[d] their resources to achieve a common business purpose....”

831 S.W.2d at 875.

There is a growing body of Texas case law addressing the single business enterprise theory. Recently, the Texas Supreme Court declined to either endorse or disapprove of the single business enterprise theory. *Southern Union Co. v. City of Edinburg*, 129 S.W.3d 74, 87 (Tex. 2003) (“We need not decide today whether a theory of ‘single business enterprise’ is a necessary addition to the theory of alter ego for disregarding corporate structure or the theories of joint venture, joint enterprise, or partnership for imposing joint and several liability.”). The court stated that it need not address the parameters of the single business enterprise theory because, whatever label was applied, the plaintiff’s attempt to treat various entities as a single entity was encompassed within Article 2.21 of the TBCA, and the plaintiff failed to satisfy the actual fraud standard imposed by the statute. Thus, the court joined other courts that have concluded the single business enterprise theory falls within the scope of Article 2.21A(2), which requires a showing of actual fraud in order to hold a shareholder or affiliate liable for a corporation’s contractual or contractually-related obligation on the basis of alter ego, actual fraud, constructive fraud, sham to perpetrate a fraud, “or other similar theory.” *Southern Union Co. v. City of Edinburg*, 129 S.W.3d 74, 87-89 (Tex. 2003); *Olympic Financial Ltd. v. Consumer Credit Corp.*, 9 F.Supp.2d 726 (S.D. Tex. 1998); *Nordar Holdings, Inc. v. Western Securities (USA) Ltd.*, 969 F.Supp. 420 (N.D. Tex. 1997). These cases illustrate the difficulty a plaintiff faces in a veil piercing case when the statutory actual fraud standard is applicable. In each of these cases, the plaintiff’s veil piercing claim failed for lack of a showing of actual fraud. In the tort context, however, the single business enterprise theory has proved a more potent weapon. See, e.g., *North American Van Lines v. Emmons*, 50 S.W.3d 103 (Tex.App.—Beaumont 2001, no pet.); *Hall v. Timmons*, 987 S.W.2d 248 (Tex.App.—Beaumont 1999, no pet.); *Nichols v. Pabtex, Inc.*, 151 F.Supp.2d 772 (E.D. Tex. 2001).

In *North American Van Lines v. Emmons*, 50 S.W.3d 103 (Tex.App.–Beaumont 2001, no pet.), the court held that the single business enterprise theory is distinct from the alter ego theory and that the evidence supported the jury’s finding that a parent and subsidiary constituted a “single business enterprise” even though the evidence was insufficient to establish alter ego. According to the court, the alter ego theory “generally involves proof of fraud,” whereas the single business enterprise theory “relies on equity analogies to partnership principles of liability.” The single business enterprise theory “looks to see if principles of equity support a holding that the two entities should be treated as one for purposes of liability for their acts.” The court found that the control the parent exercised over its subsidiary was “part of the normal framework of a parent/subsidiary relationship” and did not require a finding of alter ego. However, the court concluded that the evidence was sufficient for the jury to find that the parent and subsidiary were operated as a single business enterprise. The evidence included the following: common officers, common employees, the subsidiary was created so that the parent’s agents in Texas could pool their authority and create a broader coverage in the state, the parent described its relationships with its agents as a mutually dependent and cooperative enterprise, the parent received all the profits from the subsidiary, the van driver was wearing a uniform with the parent company’s name on it for a move purportedly on behalf of the subsidiary, the parent performed various administrative functions for the subsidiary, and the accident report described the driver as a driver of the parent company. The case was a personal injury case arising out of the negligent operation of a moving van; therefore, the court was not required to address whether the actual fraud requirement of Article 2.21A(2) of the TBCA applies to the single business enterprise theory. In *De La Hoya v. Coldwell Banker Mexico, Inc.*, 125 Fed.Appx. 533, 538-39 (5th Cir. 2005), the Fifth Circuit interpreted the Texas Supreme Court’s decision in *Southern Union* as limited to contract cases and held that a showing of actual fraud is not required to impose liability under the single business enterprise theory in a negligence case.

The single business enterprise theory continues to find acceptance in the courts of appeals even though the Texas Supreme Court appeared to express doubts about the theory in the *Southern Union* case. In *National Plan Administrators, Inc. v. National Health Ins. Co.*, 150 S.W.3d 718, 744 (Tex.App.–Austin 2004, pet. granted), the court of appeals noted that the Texas Supreme Court has not spoken on the viability of the “single business enterprise” theory, but noted that three of its sister courts of appeals in the past five years had

recognized the theory as a valid veil piercing theory. The court recognized the theory as valid and found the evidence sufficient to hold a parent corporation liable for the acts of its subsidiary. The court concluded the parent corporation failed to preserve its argument that, because the actions giving rise to damages arose out of a contractual obligation, the case was governed by Article 2.21 of the TBCA.

The single business enterprise theory has been applied in the context of personal jurisdiction as a basis to exercise jurisdiction over a parent corporation based on the contacts of its subsidiary. *See, e.g., Bridgestone Corp. v. Lopez*, 131 S.W.3d 670 (Tex.App.–Corpus Christi 2004, pet. granted, judgment vacated w.r.m.); *El Puerto De Liverpool, S.A. de C.V. v. Servi Mundo Llantero S.A. de C.V.*, 82 S.W.3d 622 (Tex.App.–Corpus Christi 2002, pet. dismissed w.o.j.). *See also PHC-Minden, L.P. v. Kimberly Clark Corp.*, 202 S.W.3d 193 (Tex.App.–Tyler 2005, pet. granted) (applying single business enterprise theory to exercise personal jurisdiction over subsidiary limited partnership based on contacts of parent corporation).

5. Reverse Corporate Veil Piercing

Occasionally, a party will attempt to use the alter ego doctrine to characterize the assets of a corporation as the assets of its shareholder. Such “reverse piercing” may be sought in order to hold a corporation liable for the controlling shareholder’s debt. *See Chao v. Occupational Safety and Health Review Comm’n*, 401 F.3d 355, 364-66 (5th Cir. 2005); *Zahra Spiritual Trust v. United States*, 910 F.2d 240, 243-44 (5th Cir. 1990). Reverse piercing is also used in the divorce context to permit the court to reach corporate assets and divide them as part of the community estate. *See Boyo v. Boyo*, 196 S.W.3d 409, 419-21 (Tex.App.–Beaumont 2006, no pet.); *Lifshutz v. Lifshutz*, 61 S.W.3d 511, 516-18 (Tex.App.–San Antonio 2001, pet. denied); *Zisblatt v. Zisblatt*, 693 S.W.2d 944, 952 (Tex.App.–Fort Worth 1985, writ dismissed).

III. Limited Liability Companies

A. Limited Liability of Members

A limited liability company (LLC) provides its members a full liability shield. The Texas Limited Liability Company Act (the "TLLCA") states that "a member or manager is not liable for the debts, obligations or liabilities of a limited liability company" unless the LLC regulations specifically provide otherwise. Tex. Rev. Civ. Stat. art. 1528n, art. 4.03A. The BOC likewise provides for limited liability of members and managers except to the extent the company agreement specifically provides otherwise. Bus. Org. Code § 101.114. (The "regulations" are referred to as the "company agreement" under the BOC.) Under the prior tax classification regulations, it was, on occasion, preferable to subject a member (such as a corporation formed for this purpose) to liability in order to possess another corporate characteristic deemed desirable in that particular instance. With the advent of the "check-the-box" approach, there would not ordinarily be any reason to waive a member's limited liability. In addition to expressly providing for limited liability of LLC members, the Texas LLC statutes state that a member of an LLC is not a proper party to proceedings by or against an LLC except where the object is to enforce a member's right against or liability to the LLC. Tex. Rev. Civ. Stat. art. 1528n, art. 4.03C; Bus. Org. Code § 101.113.

B. Piercing the LLC Veil

Generally the courts should respect the principle that the LLC is an entity separate and distinct from its members just as a corporation is an entity separate and distinct from its shareholders. See *Ingalls v. Standard Gypsum, L.L.C.*, 70 S.W.3d 252 (Tex.App.—San Antonio 2001, pet. denied) (analogizing to corporate parents and subsidiaries in rejecting argument that LLC's members were included with LLC as "employer" under the Workers' Compensation Act). Of course, it is possible to "pierce the veil" of a corporation and hold a shareholder liable for a corporate debt or obligation under certain circumstances. The TLLCA and BOC do not address whether or under what circumstances a claimant may "pierce" the liability shield of an LLC in order to hold a member liable for a debt or liability of the LLC. While the statutes pronounce that members of an LLC have no liability for the debts and obligations of the LLC and are not proper parties to a proceeding against an LLC (Tex. Rev. Civ. Stat. art. 1528n, art. 4.03; Bus. Org. Code §§ 101.113-101.114), courts in Texas and other jurisdictions have predictably been presented with the argument that the circumstances of a particular case justify disregarding the general rule of limited liability of members and holding a member or members personally

liable with respect to an LLC liability. In some states, the LLC statutes specifically adopt corporate veil piercing principles. See, e.g., Cal. Corp. Code § 17101(a) & (b) (providing for limited liability of members, but adopting common law alter ego doctrine as applied to corporate shareholders except that failure to follow formalities with respect to calling and conducting meetings shall not be considered). In others, like Texas, the statutes are silent regarding piercing. See, e.g., Nev. Rev. Stat. §§ 86.371, 86.381 (providing that members have limited liability and are not proper parties in a proceeding against an LLC without addressing whether piercing exceptions may apply).

Courts in Texas and other jurisdictions have relied on corporate veil piercing principles when presented with the question of whether to pierce the LLC veil. See, e.g., *Pinebrook Properties, Ltd. v. Brookhaven Lake Property Owners Ass'n*, 77 S.W.3d 487 (Tex.App.—Texarkana 2002, pet. denied) (applying corporate alter ego veil piercing precedent in analyzing plaintiff's attempt to pierce veil of LLC general partner of limited partnership and concluding evidence did not support finding of alter ego); *In re Valley X-Ray Co. (Shapiro v. VPA, P.C.)*, __ B.R.__, 2007 WL 37755 (E.D. Mich. 2007) (stating principles to disregard limited liability of LLC are same as for corporation and concluding LLC and former 51% member were not alter egos); *In re Kilroy*, 357 B.R. 411 (Bankr. S.D. Tex. 2006) (noting dearth of Delaware case law on question of whether corporate veil piercing principles apply to Delaware LLCs, but concluding Court of Chancery has conceptually endorsed application of corporate piercing principles to LLCs and finding evidence sufficient to treat Delaware LLC as alter ego of debtor); *D'Elia v. Rice Development, Inc.*, 147 P.3d 515 (Utah App. 2006) (applying Utah veil piercing principles to Utah LLC and California veil piercing principles to California corporation and affirming trial court's determination that evidence did not support piercing entity veils because plaintiff encouraged informal and lax practices relied upon as justification to pierce veils); *Troutwine Estates Development Company, LLC v. Comsub Design and Engineering, Inc.*, 854 N.E.2d 890 (Ind. App. 2006) (concluding corporate veil piercing principles apply to Indiana LLCs and discussing such principles but remanding because trial court did not state findings of fact supporting personal liability of LLC members); *In re Weddle (Elsaesser v. Cougar Crest Lodge, LLC)*, 353 B.R. 892 (Bankr. D. Idaho 2006) (concluding that Idaho courts would apply corporate veil piercing principles to LLCs, but finding no support for plaintiff's allegation that failure to treat LLC and member as alter egos would lead to inequitable result); *Milk v. Total Pay and HR Solutions, Inc.*, 634 S.E.2d 208 (Ga. App. 2006)

(rejecting plaintiff's argument that LLC veil should be pierced based on undercapitalization because evidence did not show intent to avoid payment of future debts at time of capitalization); *In re Teknek (Fisher v. Hamilton)*, 343 B.R. 850 (Bankr. N.D. Ill. 2006) (commenting that LLCs may be subject to veil piercing in manner similar to piercing corporate veil under corporate alter ego doctrine); *Anderson, LLC v. Stewart*, ___ S.W.3d ___, 2006 WL 1118892 (Ark. 2006) (declining to address extent to which corporate veil piercing doctrine applies to LLC owners because issue was not raised in briefing, and concluding trial court's decision to pierce LLC veil was not clearly erroneous assuming corporate veil piercing principles applied); *In re Brentwood Golf Club, LLC*, 329 B.R. 802 (Bankr. E.D. Mich. 2005) (determining that LLC debtor and related LLC were alter egos and veil of related LLC would thus be pierced so that related LLC's assets were property of bankruptcy estate); *Lily Transportation Corp. v. Royal Institutional Services, Inc.*, 832 N.E.2d 666 (Mass. App. Ct. 2005) (finding misleading conduct of member and related entity was not basis to pierce LLC veil, and declining to hold two members who were not involved in misleading conduct liable in any event, relying on corporate case law and other authorities that have concluded stockholders who have not been involved in abuse of corporate form are not liable when corporate veil is pierced); *Morris v. Cee Dee, LLC*, 877 A.2d. 899 (Conn. App. 2005) (holding evidence did not support piercing LLC veil, but there was probable cause to believe member himself was negligent in connection with plaintiffs' claim); *Merrell-Benco Agency, LLC v. HSBC Bank USA*, 799 N.Y.S.2d 590 (N.Y. A.D. 3 Dept. 2005) (stating that LLC that was currently sole owner of another LLC would not be liable for LLC subsidiary's debt, even if parent LLC had been in existence at time debt was incurred, because parent company generally will not be liable for obligations of its subsidiary unless it can be shown parent exercised complete domination and control); *Milistar (NY) Inc. v. Natasha Diamond Jewelry Manufacturers, LLC*, 797 N.Y.S.2d 10 (N.Y. A. D. 1 Dept. 2005) (stating evidence in record established LLC was "not a legal corporation, but rather a mere alter ego of [individual defendant] and the corporation's debt should thus be imputed to [defendant] individually"); *S.R. International Business Insurance Co., Ltd. v. World Trade Center Properties, LLC*, 375 F.Supp.2d 238 (S.D. N.Y. 2005) (concluding Delaware veil piercing law would apply to question of whether Delaware LLC's veil should be pierced and discussing veil piercing standard under Delaware alter ego theory, but finding it unnecessary to pierce LLC's veil); *Retropilis, Inc. v. 14th Street Development, LLC*, 797 N.Y.S.2d 1 (N.Y. A.D. 1 Dept. 2005) (concluding allegations were insufficient to

support claim to pierce LLC veil where only three of more than 70 checks tendered by plaintiff were mistakenly deposited into wrong entity's account and were immediately transferred to proper account upon discovery of error, and no checks were deposited into member's personal account); *In re Giampietro (AE Restaurant Assocs., LLC v. Giampietro)*, 316 B.R. 841 (Bankr. D. Nev. 2004) (rejecting argument that silence of LLC statute regarding veil piercing precluded application of piercing principles, and concluding Nevada corporate veil piercing principles apply in LLC context, but finding evidence did not warrant piercing of LLC veil); *Lee v. Clinical Research Center of Florida, L.C.*, 889 So.2d 317 (La.App. 2004) (applying single business enterprise analysis to LLC and various affiliated LLCs and concluding evidence did not suffice to characterize the LLCs as single business enterprise); *FILO America, Inc. v. Olhoss Trading Company, LLC*, 321 F.Supp.2d 1266 (M.D. Ala. 2004) (concluding that it is possible to pierce LLC veil under Alabama law and that plaintiff stated claim to pierce defendant LLC's veil by alleging members had fraudulent purpose in conception of their business, but noting that some factors applied in corporate veil piercing may not apply to LLCs in same manner they apply to corporations); *Advanced Telephone Systems, Inc. v. Com-Net Professional Mobile Radio, LLC*, 846 A.2d 1264 (Pa. Super. 2004) (concluding that trial court did not abuse its discretion in refusing to pierce LLC veil even though there was evidence of lack of formalities where lack of formalities did not lead to misuse of corporate form so as to justify piercing); *In re Crowe Rope Industries, LLC (Turner v. JPB Enterprises, Inc.)*, 307 B.R. 1 (D. Me. 2004) (noting standard for piercing LLC veil under Maine law is same as for corporation, and concluding Maine law would not permit corporation to pierce its own veil (based on Maine Supreme Court's rejection of "reverse piercing" by shareholder of corporation to assert corporation's rights) and thus Trustee could not assert alter ego claim on behalf of estate); *In re Trexler (Trexler v. I.P., L.L.C.)*, 259 B.R. 573 (Bankr.D. S.C. 2003) (holding that allegation LLC filed annual reports with Secretary of State and evidence of minutes of meetings indicated LLC adhered to some formalities and established meretorious defense to piercing allegations for purposes of challenge to default judgment, but affirming default judgment because defendants failed to show excusable neglect or other equitable basis for relief); *KLM Industries, Inc. v. Tylutki*, 815 A.2d 688 (Conn. App. 2003) (noting trial court's reference to corporate defendant as LLC was incorrect and disagreeing with trial court's decision to pierce corporate veil, but agreeing with trial court that determination of whether to pierce veil of corporation or

LLC requires same analysis); *Bonner v. Brunson*, 585 S.E.2d 917 (Ga. App. 2003) (holding that evidence did not support piercing LLC veil to hold member personally liable because payments to member, member's wife, and member's corporation did not amount to abuse of LLC form by commingling or confusing LLC business with member's personal affairs); *Imperial Trading Co., Inc. v. Uter*, 837 So.2d 663 (La.App. 2002) (affirming trial court's finding that plaintiff failed to prove LLCs were disregarded to extent they were indistinguishable from their members under corporate veil piercing standards, and noting that such ruling did not constitute any opinion as to whether piercing is available with respect to LLC as it is with respect to corporation); *Hunter v. Youthstream Media Networks, Inc.*, 241 F.Supp.2d 52 (D. Mass. 2002) (relying on corporate veil piercing principles in denying pre-trial equitable attachment on basis plaintiff failed to establish likelihood of prevailing on piercing claim against LLC member); *Kaycee Land and Livestock v. Flahive*, 46 P.3d 323 (Wyo.2002) (concluding that there was no legal or policy reason to treat LLCs differently from corporations for purposes of veil piercing but acknowledging that precise application of factors may differ based upon inherently more flexible and informal nature of LLCs); *In re Securities Investor Protection Corp. v. R.D. Kushnir & Co.*, 274 B.R. 768 (Bankr.N.D.Ill.2002) (concluding that, while Illinois LLC act precludes piercing on basis of failure to follow formalities, nothing in statute bars piercing LLC veil on other grounds applicable to corporations); *Collins v. E-Magine, LLC*, 739 N.Y.S.2d 15 (N.Y.A.D.1 Dept.2002) (recognizing statutory liability protection of LLC members and managers and holding plaintiff failed to raise triable issue on alter ego); *Bastan v. RJM & Associates, LLC*, 29 Conn. L. Rptr. 646 (Conn.Super.2001) (rejecting argument of individual sole member of LLC that there can be no equitable piercing of member-managed LLC); *Hollowell v. Orleans Regional Hosp. LLC*, 217 F.3d 379 (5th Cir.2000) (rejecting challenges to jury's findings of alter ego and single business enterprise in WARN Act case against LLC and various affiliated individuals and entities); *Hamilton v. AAI Ventures, L.L.C.*, 768 So.2d 298 (La.App.2000) (applying corporate veil piercing principles in upholding trial court's piercing of LLC veil to hold member liable on LLC's contract); *GMAC Commercial Mortgage Corp. v. Gleichman*, 84 F.Supp.2d 127 (D.Me.1999)(referring to LLC and its sole member in corporate terms throughout most of opinion and concluding that pleadings were sufficient to allege misuse of "corporate form" and "inequitable outcome if the Court recognizes [the LLC's] corporate from"); *Ditty v. CheckRite, Ltd., Inc.*, 973 F.Supp. 1320 (D.Utah 1997) (concluding that corporate alter ego

doctrine applies to LLCs but that plaintiffs had not produced sufficient summary judgment evidence to pierce LLC veil as matter of law).

In *Pinebrook Properties, Ltd. v. Brookhaven Lake Property Owners Association*, 77 S.W.3d 487 (Tex.App.—Texarkana 2002, pet. denied), the court, without discussing whether or why corporate veil piercing principles apply to LLCs, relied upon corporate veil piercing principles in analyzing the plaintiff's claim that an LLC was the alter ego of its member. The court cited corporate veil piercing cases and relied upon Article 2.21A(3) of the TBCA as authority for the proposition that failure to follow formalities is not a factor in determining alter ego. Although courts are not literally required to apply this provision of the TBCA (or its successor in Chapter 21 of the BOC) to LLCs, there is no apparent policy reason not to apply consistent standards. Likewise, if veil piercing is to apply to Texas LLCs, the standard set by the provisions of Article 2.21A(2) of the TBCA and Section 21.223(a)(2) of the BOC (requiring actual fraud to pierce the corporate veil to impose liability for an obligation arising out of a contract of a corporation) would seemingly be appropriate in the context of LLCs.

In *DDH Aviation, LLC v. Holly*, 2005 WL 770595 (N.D. Tex. March 31, 2005), the court relied upon Texas corporate veil piercing principles in analyzing whether to pierce the veil of a Texas LLC. The opinion states that DDH was initially "formed as a corporation but later altered its business form to become a limited liability company." The court does not indicate when the change in form took place or what events took place while DDH was a corporation versus an LLC. At one point in the opinion, the court identifies DDH as a "limited liability corporation." Thus, it is not clear that the court made a conscious decision to apply corporate veil piercing principles to an LLC or whether the court even recognized the distinction between an LLC and a corporation.

In *re JNS Aviation, LLC (Nick Corp. v. JNS Aviation, Inc.)*, 350 B.R. 283 (Bankr. N.D. Tex. 2006) is another case in which the question of whether veil piercing principles apply to LLCs is not directly posed, but the discussion proceeds on the assumption that veil piercing principles apply to LLCs. The court analyzed whether certain piercing claims being asserted in the case were property of the LLC debtor's estate and declined to approve a settlement relating to fraudulent transfer and breach of fiduciary duty claims where the settlement purported to encompass the piercing claims.

"Reverse piercing," i.e., holding the LLC liable for a member's obligation, or otherwise treating the LLC's assets as the assets of the owner, has been upheld in some cases. See *Litchfield Asset Mgmt. Corp. v.*

Howell, 799 A.2d 298 (Conn. App.2002); *Great Neck Plaza, L.P. v. Le Peep Restaurant, LLC*, 37 P.3d 485 (Colo.App.2001); *see also In re Turner (Kendall v. Turner)*, 335 B.R. 140 (Bankr. N.D. Cal. 2005). *Cf. In re Bianchini (Bianchini v. Ryan)*, 346 B.R. 593 (Bankr. D. Conn. 2006) (commenting that many jurisdictions permit both offensive and defensive reverse piercing, but declining to allow debtor to benefit by disregarding record title to property placed in LLC for unjust purposes).

Piercing the LLC veil is also addressed in a number of cases involving a court's exercise of personal jurisdiction over LLC members or managers. *See, e.g., Wolf v. Summers-Wood, L.P.*, 214 S.W.3d 783 (Tex.App.—Dallas 2007, no pet. h.); *Morris v. Powell*, 150 S.W.3d 212 (Tex.App.—San Antonio 2004, no pet.); *Stauffer v. Lone Star Mud, Inc.*, 54 S.W.3d 810 (Tex.App.—Texarkana 2001, no pet.); *Royal Mortgage Corp. v. Montague*, 41 S.W.3d 721 (Tex.App.—Ft. Worth 2001, no pet.); *Quebecor World (USA), Inc. v. Harsha Assocs. L.L.C.*, 455 F.Supp.2d 236 (W.D. N.Y. 2006); *LaSalle Bank N.A. v. Mobile Hotel Properties, LLC*, 274 F.Supp.2d 1293 (S.D. Ala. 2003); *XL Vision, LLC v. Holloway*, 850 So.2d 1063 (Fla. App. 2003); *International Bancorp, L.L.C. v. Societe des Bains de Mer et du Cercle des Entrangers a Monaco*, 192 F.Supp.2d 467 (E.D. Va. 2002); *ING (U.S.) Securities, Futures & Options, Inc. v. Bingham Inv. Fund, L.L.C.*, 934 F.Supp. 987 (N.D. Ill.1996).

IV. Limited Partnerships

Limited partnerships have been a popular form of business entity in Texas in recent years because they have not been subject to the Texas franchise tax. Effective January 1, 2008, limited partnerships will generally be subject to the new margin tax. Limited partnerships that qualify as “passive” under the new margin tax provisions will be exempt from the franchise tax, but operating businesses that are structured as limited partnerships will be subject to the margin tax. The issues associated with liability protection in the limited partnership form are more complicated than they are in the corporate or LLC form. With the elimination of the state tax advantage that limited partnerships have enjoyed and the additional complexities associated with owner liability protection, limited partnerships are likely to decrease in popularity, at least for operating businesses.

A. General Partner Personal Liability

General partners in a limited partnership have joint and several personal liability for all the debts and obligations of the partnership. Corporate or LLC general partners are commonly used to minimize this

disadvantage; however, this technique complicates the structure and involves some additional expense (legal and filing fees associated with formation of an additional entity, franchise tax liability of the entity general partner, accounting fees associated with filing additional tax returns, etc.). Liability issues associated with this more complicated structure are further discussed below.

B. Limited Partner Limited Liability; Statutory Exceptions

Under the Texas Revised Limited Partnership Act (“TRLPA”), a limited partner is not liable for partnership debts and obligations unless (i) the limited partner is also a general partner, (ii) the limited partner participates in the control of the business and a person transacting business with the limited partnership reasonably believes, based upon the limited partner's conduct, that the limited partner is a general partner, or (iii) the limited partner permits its name to be used in the partnership name and a creditor extends credit to the partnership without knowledge that the limited partner is not a general partner. Tex. Rev. Civ. Stat. art. 6132a-1, § 3.03. Section 153.102 of the BOC carries forward these rules with one exception. The prohibition on use of a limited partner's name in the limited partnership name (and the resulting potential liability if the limited partner's name is so used) has not been carried forward in the BOC. *See* Bus. Org. Code §§ 5.055, 153.102.

The risk associated with participation in the control of the business may appear at first blush to be a substantial threat to a limited partner's liability protection; however, the statute's lengthy laundry list of activities that are deemed not to constitute participation in the control of the business provides a limited partner substantial leeway in this area.³ Tex. Rev. Civ. Stat. art. 6132a-1, § 3.03(b); Bus. Org. Code § 153.103-153.104. Even assuming a limited partner's activities fall outside the safe harbor and constitute participation in the control of the business, the reliance test provides another hurdle a creditor must overcome to hold the limited partner liable as a general partner. Tex. Rev. Civ. Stat. art.

³The limited partnership statutes of many other states contain similar provisions exposing a limited partner to liability for participation in the control of the business and providing safe harbor activities that do not constitute participation in the control of the business. The new Uniform Limited Partnership Act (2001) (“ULPA 2001”), which is a complete revision of the prior Revised Uniform Limited Partnership Act (1976 with 1985 amendments), provides for limited liability of limited partners without regard to whether they participate in the control of the business. ULPA 2001 has been adopted in twelve states.

6132a-1, § 3.03(a); Bus. Org. Code § 153.102(b). There are certain exceptions to the TRLPA prohibition on use of a limited partner's name in the partnership name. The TRLPA permits a limited partner's name to be used in the partnership name in the following circumstances: (i) the limited partner's name is also the name of a general partner, or (ii) the business of the limited partnership had been carried on under that name prior to admission of the limited partner. Tex. Rev. Civ. Stat. art. 6132a-1, § 1.03(1).

The statutory laundry list of capacities and powers that do not constitute participation in control by a limited partner is quite broad. For example, the provision states that a limited partner does not participate in control so as to risk liability for the partnership's obligations if the limited partner acts as contractor for or agent or employee of the partnership or a general partner, an officer, director or shareholder of a corporate general partner, a partner of a partnership that is a general partner, a member or manager of an LLC general partner, or any similar capacity with any person that is a general partner. Tex. Rev. Civ. Stat. art. 6132a-1, § 3.03(b)(1); Bus. Org. Code § 153.103(1). This provision is frequently relied upon to involve limited partners in management of the limited partnership through ownership and management of a corporate or LLC general partner.

C. Risk Associated With Complexity of Corporate or LLC General Partners

As noted above, corporate or LLC general partners are frequently used to avoid exposing individuals to liability as general partners. Often-times, one or more individuals involved in the corporate or LLC general partner are limited partners who must avoid "participating in control" of the business of the partnership to preserve their liability protection as limited partners. The statutory carve-outs regarding participation in control permit a limited partner to act as a shareholder, officer, or director of a corporate general partner, or as a member or manager of an LLC general partner, and, theoretically, there should be little risk in doing so. However, the practical down-side is the complexity that comes with this approach. Consider the proper signature form for a limited partnership contract being executed by an individual acting as president of the corporate general partner:

XYZ Enterprises, LTD.

By: XYZ Management, Inc., general partner

By: _____
Jane Jones, president

It would not be surprising if Jane Jones forgot one or more designations involved in the various agency relationships reflected above. If Jane Jones is sloppy in this regard, there may then be an issue as to the capacity in which she was acting or appeared to be acting, and her liability protection may be jeopardized. It may be easier for Jane Jones to understand and remember her role if she is simply appointed an officer of the limited partnership. Though there is no explicit provision in the TRLPA for officers of limited partnerships, Section 3.03 recognizes that a limited partner may serve as an "agent" of the limited partnership without thereby "participating in control" of the partnership, and there is nothing in the TRLPA that would appear to preclude the partnership agreement from providing for officer/agents. The BOC expressly provides that officers of a domestic entity (which includes a limited partnership) may be elected or appointed in accordance with the entity's governing documents (i.e., the partnership agreement) or by the governing authority (i.e., the general partner(s)) unless prohibited by the governing documents. Bus. Org. Code § 3.103(a).

Given the carve-outs of "participation in control" and the creditor reliance test, the statutory protection of a limited partner appears quite strong, but there are cases in which the court's application of these provisions was not as clear-cut as limited partners would hope. See *Humphreys v. Medical Towers, Ltd.*, 893 F.Supp. 672 (S.D. Tex. 1995), aff'd without opinion, 100 F.3d 952 (5th Cir. 1996); *Tapps of Nassau Supermarkets, Inc. v. Linden Boulevard L.P.*, 661 N.Y.S.2d 223 (N.Y. Sup. Ct. App. Div. 1st Dept.).

In *Humphreys v. Medical Towers, Ltd.*, *supra*, a building manager brought a sexual harassment suit against her employer, a limited partnership that owned the building. The plaintiff also sued an individual, Lawson, who was a limited partner and the sole shareholder and president of the corporate general partner. The court acknowledged that Section 3.03 of the TRLPA provides that a limited partner is not liable for the obligations of the partnership unless the limited partner participates in the control of the business and a person transacting business with the partnership reasonably believes that the limited partner is a general partner. The court also acknowledged that Section 3.03 states that a limited partner does not participate in the control of the business by acting as an officer, director, or shareholder of a corporate general partner. Nevertheless the court denied Lawson's motion for summary judgment. In support of its conclusion that there were fact issues on this matter, the court noted the following: the plaintiff's assertion that Lawson controlled all aspects of the business; the plaintiff's assertion that she reasonably believed him to be a

general partner since he reported to no one else and had complete control of the limited partnership; the plaintiff's assertion that Lawson never said he was merely a limited partner and that she did not see any document stating that he was merely a limited partner; deposition testimony from the bookkeeper of the partnership that Lawson was the general partner; deposition testimony from the stationary engineer that Lawson owned the building.

D. Veil Piercing of Limited Partnership or Entity General Partners

1. Piercing the Limited Partnership Veil

There is little case law dealing with veil piercing of limited partnerships, presumably because there is always at least one general partner who has personal liability for the debts and obligations of the partnership (absent an LLP registration, a relatively recent phenomenon, and one available to limited partnerships in fewer than half the states). When veil piercing of the limited partnership has been pursued, it has tended to involve a reverse piercing claim to hold the limited partnership liable with respect to liabilities of the general partner. For example, in *Carr v. Weiss*, 984 S.W.2d 753 (Tex.App.—Amarillo 1999, pet. denied), the general partner of an Oklahoma limited partnership was held liable for damages and constructive trust arising out of breach of an oral agreement to purchase and jointly own an apartment complex. The limited partnership, which held title to the apartment complex, was found to be the general partner's alter ego and thus jointly and severally liable with the general partner. In *Northern Tankers (Cyprus) Ltd. v. Backstrom*, 967 F.Supp. 1391 (D.Conn.1997), a federal maritime case, the court applied the alter ego theory to reverse pierce various entities the court found were fraudulently created as personal investment vehicles for an individual. The court was apparently referring to a group of entities that owned substantial real estate and personal property in Colorado. The group consisted of a grantor trust, two corporations, a limited partnership, and two LLCs. The court specifically found that the limited partnership and its corporate general partner were "alter egos" of the individual and expressly disregarded their "corporate" existence. In *C. F. Trust, Inc. v. First Flight Ltd. P'ship*, 580 S.E.2d 806 (Va. 2003), the Virginia Supreme Court held that Virginia recognizes the concept of outsider reverse veil-piercing and that the concept can be applied to limited partnerships. In *Lifshutz v. Lifshutz*, 61 S.W.2d 511 (Tex.App.—San Antonio 2001, pet. denied), the trial court pierced the veil of various corporate and partnership entities in which the husband's ownership interests were separate property in order to reach and

characterize assets of the entities as community property. On appeal, the court held that the Texas Revised Partnership Act does not permit a court to award assets of a partnership to a non-partner spouse in a divorce action, relying on Section 5.01 of the TRPA (dealing with partnership property) and the commentary to that section.

One Texas court of appeals has held that the alter ego doctrine is inapplicable to a partnership. *Pinebrook Properties, Ltd. v. Brookhaven Lake Property Owners Ass'n*, 77 S.W.3d 487, 499-500 (Tex.App.—Texarkana 2002, pet. denied). The court reasoned that "there is no veil that needs piercing, even when dealing with a limited partnership, because the general partner is always liable for the debts and obligations of the partnership to third parties." This statement obviously raises the question of the applicability of veil piercing to registered limited liability partnerships. The court did not address that possibility. Cf. *Skidmore Energy, Inc. v. KPMG*, 2004 WL 3019097 (N.D. Tex. 2004) (citing *Pinebrook Properties* in support of statement that alter ego liability was inapplicable to relationship between KPMG LLP and its Moroccan member firm because KPMG is not corporate entity but an LLP organized under Delaware law).

2. Piercing the Entity General Partner

The use of entity general partners to shield upstream parties from liability has become common. Often these entities are formed for the sole purpose of serving as general partner of a limited partnership; thus, the activities of such an entity consist solely of acting in a managerial capacity for the partnership. The question arises: What level of capitalization is appropriate to avoid being characterized as "undercapitalized" for veil piercing purposes? There is not a great deal of case law addressing this or other veil piercing issues in this context. In the cases in which the issue has arisen, some courts have been more receptive to veil piercing arguments than others.

In *Paul Steelman, Ltd. v. Omni Realty Partners*, 885 P.2d 549 (Nev.1994), the Nevada Supreme Court was not troubled by a corporate general partner that was capitalized with only a \$200 receivable. In that case, a partnership creditor sought to hold the shareholders of the corporate general partner personally liable for a partnership debt. The court acknowledged that the corporation was formed to shield individuals from liability as general partners. The plaintiff claimed that the corporate general partner should be pierced because it was intentionally undercapitalized. Although the corporation was only capitalized with a \$200 receivable, the court stated that the real value of the corporation was

best measured by the collective expertise of its shareholders. The court noted that the record established that the manner of capitalization was not uncommon for corporations of its type and that the limited partnership itself was adequately capitalized. The court stated that undercapitalization is only one factor to be considered in a piercing case and concluded that, assuming *arguendo* the corporation was undercapitalized, there was no showing the corporation was a sham designed to perpetuate fraud or injustice.

In *Pinebrook Properties, Ltd. v. Brookhaven Lake Owners Ass'n*, 77 S.W.3d 487 (Tex.App.—Texarkana 2002, pet. denied), the court of appeals found that there was no evidence to support the trial court's finding that an LLC general partner was the alter ego of the LLC's member. The court recognized that an LLC is a separate entity that provides liability protection to its members but went on to analyze whether there was evidence to support the trial court's alter ego finding. The court of appeals apparently assumed that the corporate alter ego doctrine was applicable to an LLC; however, the court found no evidence to support the finding that the LLC general partner was the alter ego of its member. (The court cited corporate veil piercing cases and even relied on Article 2.21 of the TBCA, which does not literally encompass LLCs, in the course of its discussion. While courts are not statutorily required to apply the provisions of Article 2.21 in the LLC context, to the extent courts determine it is appropriate to apply veil piercing principles to LLCs, there is no logical rationale for applying different standards to LLCs and corporations.) The standard the court applied was whether there was evidence that there was a unity of interest between Musgrave, the LLC's member, and the LLC such that the separateness had ceased to exist and holding only the LLC as the general partner liable would result in injustice. The evidence of alter ego presented was that the LLC had no checking account and had not filed a tax return, and that Musgrave had sent a letter under his own signature without designating any representative capacity. A second letter signed without designating any representative capacity was also argued to show lack of regard for the "corporate" structure. Additionally, there was evidence that the LLC's only source of income was contributions or loans from Musgrave, and Musgrave once made a statement characterizing himself as the owner of the property owned by the limited partnership. The court noted that the evidence clearly showed that the LLC had never had the need, or been required, to file a tax return. (Presumably, the LLC was a disregarded entity for tax purposes under the check-the-box rules because Musgrave was its sole member.) The court stated that lack of corporate formalities is not a factor in

determining alter ego (relying on Article 2.21A(3) of the TBCA and corporate case law) and held that there was no evidence of alter ego, pointing to the absence of evidence that Musgrave commingled funds or disregarded the "corporate" structure. The court noted that the evidence revealed Musgrave was not the only manager of the LLC. (The court's statement might lead to an inference that serving as the sole manager and member of an LLC would constitute evidence of lack of separateness. There is no reason, however, that a single member/manager LLC should be any more susceptible to veil piercing than a sole shareholder/director corporation. Both are authorized by statute, and such a structure in and of itself should not constitute any evidence of lack of separateness.) Further, there was no evidence that the LLC was used for personal purposes.

A federal district court applying Texas law in the case of *Humphreys v. Medical Towers, Ltd.*, 893 F.Supp. 672 (S.D.Tex.1995), aff'd without opinion, 100 F.3d 952 (5th Cir.1996), concluded that the sole shareholder and president of a corporate general partner was not entitled to summary judgment on the plaintiff's veil piercing claim. In that case, a building manager brought a sexual harassment suit against her employer, a limited partnership. The general partner was a corporation. The plaintiff sued the sole shareholder and president of the corporate general partner, alleging he was personally liable because he exercised control of the business and was the alter ego of the corporate general partner. With respect to the alter ego claim, the plaintiff pointed out that the defendant was the corporation's sole shareholder, that the corporation was undercapitalized, that it derived all of its income from the limited partnership, and that it paid some of the defendant's personal expenses. On this basis, and with little discussion, the court found that the plaintiff had raised a fact issue so as to avoid summary judgment.

Another federal district court in Texas went into greater detail in addressing the potential viability of veil piercing claims aimed at corporate general partners of two limited partnerships that owned and operated nursing homes. In *Autrey v. 22 Texas Services Inc.*, 79 F.Supp.2d 735 (S.D. Tex. 2000), a wrongful death case arising out of the death of a nursing home resident, much of the court's attention was focused on the possible undercapitalization of the corporate general partners in issue. In the case of the corporate general partner of one of the limited partnerships, the court was concerned that the corporate general partner had a net worth of "only" \$42,000 and little in the way of liquid assets when it bore "one hundred percent of the liability for the operation of numerous nursing homes." However, because the plaintiffs did not present evidence of the financial condition at the time of incorporation,

the court concluded that the plaintiffs had not conclusively established undercapitalization. The corporate general partner of the other limited partnership defendant was incorporated with an initial capitalization of “only” \$25,000 and had a negative net worth six months after formation. The court concluded that engaging in the ownership of forty-nine nursing homes while also maintaining no net assets amounted to a disputable issue regarding undercapitalization. (The overall picture was not helped by the apparent precarious financial condition of the limited partnership itself, which the court pointed out in footnotes.) As further damaging evidence, the court pointed out that the corporate general partners had no employees, office space, or expenses. In addition, with respect to the corporate general partner of one of the defendant partnerships, the court found it suspicious that there were apparently individuals who were non-functioning corporate officers.

When considering whether the corporations were adequately capitalized, the court in *Autrey* stressed that the corporate general partners were responsible for 100% of the liabilities of their respective limited partnerships. A critical step in the analysis is missing, however, if the inquiry focuses solely on whether the general partner has sufficient assets to meet the potential liabilities and obligations of the partnership. Assessment of whether a corporate general partner is adequately capitalized for its business of managing a limited partnership should include consideration of the assets and insurance of the limited partnership itself. In this regard, the defendants in the *Autrey* case argued that a combined \$21,000,000 in liability insurance made the weak balance sheets of the corporate general partners of the two defendant limited partnerships irrelevant. The court, however, found more fact issues. First, the court noted that there were possible issues as to the policies’ coverage of the occurrences in question. In addition, the court found significant the fact that there were questions as to whether the corporate general partners themselves were covered by the insurance, as to whether the corporate general partners secured and paid for the insurance, and whether the insurance coverage would have “transformed [the corporate general partners] into financially responsible corporate entities.” With respect to the issue of injustice, the court accepted, for purposes of deciding defendants’ motion for summary judgment, the plaintiff’s argument that, if proved, the effort to avoid personal liability by creating sham corporate shields constitutes a type of injustice that would satisfy that element of the piercing standard.

The veil piercing law applied by the court in *Autrey* was Pennsylvania law because the corporate general partners were incorporated in Pennsylvania.

There is little to suggest, however, that the court would have approached the issue any differently under Texas law. As discussed above, under Texas law, piercing to impose liability on a shareholder for a liability of the corporation that relates to or arises out of a contractual obligation is by statute subject to a stringent actual fraud standard. Tex. Bus. Corp. Act art. 2.21A(2). This statutory actual fraud standard is not applicable, however, to a claim that does not relate to or arise out of a contractual obligation of the corporation. Thus, even under Texas law, it does not appear that the court would have been required to apply the statutory standard to the alter ego claim. Conceivably, it might be argued that the wrongful death claim, which was based on negligent care of the nursing home resident, arose out of the nursing home’s contract to provide care to the resident, but it is unclear whether the statute may be read that broadly. That the case involved a tort claim, that the limited partnerships were in the nursing home business, and that the limited partnerships themselves may have been severely undercapitalized probably explain the court’s tone. Nevertheless, the discussion highlights areas that merit consideration in structuring a limited partnership with an entity general partner. See also *House v. 22 Texas Services, Inc.*, 60 F.Supp.2d 602 (S.D. Tex. 1999), another wrongful death case against the same limited partnerships involved in the *Autrey* case. In that case, the court pierced the corporate veil of the corporate general partners to exercise personal jurisdiction over certain individual defendants who were shareholders and officers of the corporate general partners.

V. LLPs and Limited Partnership LLPs

A registered limited liability partnership (LLP) is a partnership which has availed itself of procedures under the Texas Revised Partnership Act (“TRPA”) or BOC so as to alter the traditional rule that general partners have personal liability for all partnership debts and obligations. The statutory provisions applicable to general partnerships (or those applicable to limited partnerships in the case of a limited partnership that has registered as an LLP) continue to apply to a partnership after it registers as an LLP—it is the same entity as it was prior to registration. Section 3.08 of the TRPA and Sections 152.801-152.805 of the BOC merely modify the rule regarding liability of partners and specify the requirements for obtaining and maintaining LLP status.

Texas was the first jurisdiction to pass LLP legislation in 1991. The concept was quickly copied in other states, and all states and the District of Columbia added LLP provisions to their partnership statutes. The major accounting firms were a significant force in lobbying for such legislation across the country.

Although the states were quick to borrow the LLP concept from Texas, they were not reluctant to vary and refine it, and there are significant variations in the LLP statutes around the country. For example, most states, like Texas, permit any type of partnership to become an LLP, while a few states permit only professional partnerships to become LLPs. Some states limit the liability protection provided by an LLP to liabilities arising out of some type of tortious or wrongful conduct, while LLPs in Texas and many other states provide partners liability protection extending to contractual obligations of the partnership. The differences among the states should be considered if a business will have dealings or contacts outside of Texas. For instance, New York statutes provide that a non-professional LLP's liability shield will not be respected in New York.

A. General Rule: Full Liability Limitation

The feature that distinguishes an LLP from a partnership that is not an LLP is the limitation on the personal liability of partners in an LLP. The TRPA and BOC provide that a partner in an LLP is not individually liable for debts and obligations of the partnership incurred while the partnership is an LLP. Tex. Rev. Civ. Stat. art. 6132b-3.08(a)(1); Bus. Org. Code § 152.801(a). As originally enacted, the Texas LLP provisions only shielded partners from liability arising out of the errors, omissions, negligence, incompetence, or malfeasance of other partners or representatives of the partnership. In 1997, the LLP provisions were amended to provide protection from all debts and obligations of the partnership as a general rule. Thus, the current language generally shields partners from tort and contract obligations of the partnership. Language was also added to prevent indirect attempts to hold partners liable through indemnity and contribution. The LLP provisions do not shield a partner from liability imposed by law or contract independently of the partner's status as a partner, such as when a partner personally commits a tort or personally guarantees a contractual obligation. Tex. Rev. Civ. Stat. art. 6132b-3.08(a)(3)(B); Bus. Org. Code § 152.801(e)(2). The limitation of partner liability also does not affect the liability of the partnership to pay its debts and obligations out of partnership property, or the manner in which service of citation or other civil process may be served in an action against a partnership. Tex. Rev. Civ. Stat. art. 6132b-3.08(a)(3)(A); Bus. Org. Code § 152.801(e)(1).

B. Exceptions to Tort-Type Liability Protection

As mentioned above, as originally enacted, the Texas LLP provisions only shielded partners from liability arising out of the errors, omissions, negligence, incompetence, or malfeasance of other partners or

representatives of the partnership. Even this protection was subject to certain exceptions. Under these exceptions, a partner's liability was not limited with respect to another's errors, omissions, negligence, incompetence, or malfeasance if such occurred under the partner's supervision, the partner was directly involved in the specific activity, or the partner had notice or knowledge and failed to take reasonable steps to prevent or cure the situation. When the 1997 amendments broadened the liability protection to all debts and obligations of the partnership, the language dealing with the exceptions to the protection from tort-type liabilities was retained. Though the construction of the TRPA provision is awkward, the apparent intent was to retain the pre-1997 exceptions from tort-type liability protection. That is, the provisions would not limit a partner's liability for another's errors, omissions, negligence, incompetence, or malfeasance if such occurred under the partner's supervision, the partner was directly involved in the specific activity, or the partner had notice or knowledge and failed to take reasonable steps to prevent or cure the situation. *See* Tex. Rev. Civ. Stat. art. 6132b-3.08(a)(2). The BOC states this principle in a less awkward fashion. *See* Bus. Org. Code § 152.801(b).

The exceptions to an LLP partner's protection from liability present some interesting questions of interpretation. First, a partner who "supervises" or "directs" the errant partner or partnership representative is not shielded from liability. Does this mean that managing partners are always liable? The Comments to the 1991 amendments suggest that the answer to this question is "no" and that the supervision should be fairly specific for liability to attach to a supervising partner. *See* Tex. Rev. Civ. Stat. art. 6132b, § 15 (repealed), Source and Comments by Alan R. Bromberg (Vernon Supp. 2005). Additionally, a partner is not shielded from liability if the partner was "directly involved" in the activity or had "notice or knowledge" of and "failed to take reasonable steps to prevent or cure" the errors, omissions, negligence, incompetence, or malfeasance. One might argue that the provisions do no more than affirm that a person is always liable for his own participation in a tort. No doubt, however, plaintiffs will seek to take advantage of these provisions to reach partners other than the errant partner or employee. In *Software Publishers Association v. Scott & Scott, LLP*, 2007 WL 92391 (N.D. Tex. 2007), the court declined to dismiss claims against the managing partner of an LLP law firm that allegedly engaged in cybersquatting and copyright and trademark infringement and dilution. The court noted that the Texas LLP statute provides for liability of a partner who is directly involved in the specific activity in which the negligence or malfeasance

of another occurred or who had notice or knowledge of negligence or malfeasance at the time of the occurrence and failed to take reasonable steps to prevent or cure the negligence or malfeasance. The court also pointed out that the liability of a partner independent of his partner status is not affected by the statute. The plaintiff alleged that the managing partner “controlled” the activities of the law firm complained of in the complaint. The court found this allegation sufficient to survive a motion to dismiss because the allegation supported recovery under the theory that the managing partner was directly involved in the wrongful conduct or had knowledge of the wrongful conduct but failed to take reasonable steps to prevent it. In the course of its discussion, the court commented that no limited liability partnership law in any state extends so far as to shield a partner from his own wrongful conduct. A Connecticut court held that two partners in a three partner LLP law firm did not have liability for the third partner’s wrongful acts toward a client where the two partners shared no benefit in the dealings of the third partner in question, did not have supervision or control over him, and did not know of the matter until after it occurred. *See Kus v. Irving*, 1999 WL 417956 (Conn. Super. 1999).

C. Expiration of Protection

A partnership must be an LLP at the time a liability is incurred for the liability limitations to apply. Thus, becoming an LLP does not affect liability for prior acts or omissions. By the same token, if the registration is not timely renewed, the liability protection ceases, and partners will have personal liability for liabilities incurred after the expiration of the registration.

To become an LLP, a partnership must file an application with the Secretary of State containing specified information. *See* Bus. Org. Code § 152.802. (A registration or renewal filed on or after January 1, 2006 is governed by the BOC even if the partnership was formed prior to 2006. Bus. Org. Code § 402.001(c), (d).) The application must be executed by a majority-in-interest of the partners, or by one or more partners authorized by a majority-in-interest of the partners, and it must be accompanied by a \$200 per partner fee. Bus. Org. Code §§ 152.802(b), 4.158(1). An initial application filed with the Secretary of State expires one year after the date of registration unless it is timely renewed. Bus. Org. Code § 152.802(e). An effective registration may be renewed by filing a renewal application before the expiration of the prior registration. Bus. Org. Code § 152.802(g). The renewal application must be accompanied by a fee of \$200 per partner. Bus. Org. Code § 4.158(2). The renewal application is effective for one year after the date the effective registration would otherwise expire. Bus. Org. Code

§ 152.801(g). The difference in this procedure and filing a certificate of formation for a corporation, LLC, or limited partnership is obvious. There is a risk that the LLP renewal might be overlooked causing an interruption in the liability protection. If the registration expires without renewal, the partnership may register again, but the statute does not have a procedure for any retroactive cure or reinstatement if renewal is overlooked. *See Apcar Investment Partners VI, Ltd. v. Gaus*, 161 S.W.3d 137 (Tex.App.–Eastland 2005, no pet. h.) (holding partners personally liable on lease executed by partnership in LLP name three years after failure to renew initial LLP registration, and rejecting “substantial compliance” argument based on clear language of LLP statute).

D. Name

An LLP’s name must contain an appropriate designator such as the abbreviation LLP. TRPA requires that an LLP’s name contain the words “registered limited liability partnership,” “limited liability partnership,” “LLP,” or “L.L.P.” Tex. Rev. Civ. Stat. art. 6132b-3.08(c). The BOC states that an LLP’s name must contain the phrase “limited liability partnership” or an abbreviation of the phrase. Bus. Org. Code §§ 5.063, 152.803. The application will have the required designator or the Secretary of State will reject its filing; however, an LLP that is careless about use of the designator in its dealings with third parties might expect a plaintiff to make an issue of it.

E. Insurance or Financial Responsibility

Although common in the first generation of LLP statutes, insurance requirements have been dropped from most LLP statutes. The Texas LLP provisions still include an insurance requirement. Tex. Rev. Civ. Stat. art. 6132b-3.08(d); Bus. Org. Code § 152.804. An LLP must carry at least \$100,000 of liability insurance designed to cover the kinds of errors, omissions, negligence, incompetence, or malfeasance for which liability is limited, or, in lieu of carrying such insurance, provide \$100,000 of funds specifically designated and segregated for the satisfaction of judgments against the partnership. Such funds may be in cash, certificates of deposit, or U.S. treasury obligations deposited in trust or in bank escrow, or may be represented by a bank letter of credit or insurance company bond. To the extent an LLP’s insurance generally covers the types of tort-type liabilities for which partners’ personal liability is limited, the LLP liability protection should be available notwithstanding certain standard exclusions in the policy’s coverage. *See* Tex. Rev. Civ. Stat. art. 6132b, § 45-C (repealed), Source and Comments by Alan R. Bromberg (Vernon Supp. 2005)(stating that actual

coverage of the misconduct which occurs is not an absolute necessity). However, a plaintiff might make an issue of policy exclusions, deductibles, etc. in an attempt to attack the liability protection. In this regard, it might be advantageous to establish segregated funds or obtain a letter of credit to avoid such issues.

In *Edward B. Elmer, M.D., P.A. v. Santa Fe Properties, Inc.*, 2006 WL 3612359 (Tex.App.–San Antonio 2006, no pet. h.), the court concluded that an LLP’s failure to carry the required insurance rendered the liability shield ineffective even though the liability in issue stemmed from breach of a lease and thus was not the type of liability that would have been covered by the insurance. The plaintiff sued the partnership and its two partners for breach of a commercial lease. The plaintiff obtained a judgment against the partnership, and that judgment was severed and became final. After the plaintiff was not able to collect the judgment from the partnership, the plaintiff obtained a summary judgment against one of the partners. The partner appealed arguing that the plaintiff’s suit against the partner was barred because the plaintiff initially obtained judgment against the partnership alleging it was an LLP. The court held that the partner was not protected from individual liability because the partnership was not a properly registered limited liability partnership under the Texas Revised Partnership Act at the time it incurred the lease obligations. The Texas LLP provisions require that an LLP carry insurance or meet certain financial responsibility requirements. The court noted that, unlike the limited partnership statute, the LLP provisions contain no substantial compliance language. Therefore, the court concluded that strict compliance with the statute is required. Although the partner itself carried errors and omissions insurance, the court pointed out that the policy did not appear to cover the partnership or the other partner. Because the partnership did not have the required insurance or other forms of financial responsibility designated by the statute, it was not a properly registered LLP, and the partner was not protected from liability.

F. LLP Case Law

There is little case law addressing the issues discussed above. In *Apcar Investment Partners VI, Ltd. v. Gaus*, 161 S.W.3d 137 (Tex.App.–Eastland 2005, no pet. h.), the court acknowledged the liability protection afforded partners in an LLP, but the partners were held personally liable on a lease executed by the partnership in its LLP name because the lease was executed more than three years after the initial registration had expired. The court found the language of the LLP statute clearly required the partnership to be registered when the lease obligation was incurred for the partners to avoid liability

on the lease. In *Bennett v. Cochran*, 2004 WL 852298 (Tex.App.–Houston [14th Dist.] 2004, no pet.), a partner in a law firm LLP argued the other partner had orally agreed to pay half of all expenses of the partnership. The court noted that partners in an LLP have no personal liability for the debts and obligations of the partnership and concluded there was no evidence the partners agreed to be personally liable for the expenses and overhead of the partnership as opposed to merely having their partnership interests equally burdened by the financial obligations of the partnership.

In *Edward B. Elmer, M.D., P.A. v. Santa Fe Properties, Inc.*, 2006 WL 3612359 (Tex.App.–San Antonio 2006, no pet. h.), the court concluded that an LLP’s failure to carry the required insurance rendered the liability shield ineffective. In *Software Publishers Association v. Scott & Scott, LLP*, 2007 WL 92391 (N.D. Tex. 2007), the court declined to dismiss claims against the managing partner of an LLP law firm that allegedly engaged in cybersquatting and copyright and trademark infringement and dilution because the complaint alleged that the managing partner “controlled” the activities of the law firm complained of in the complaint. This allegation was sufficient to survive a motion to dismiss because the allegation supported recovery under the theory that the managing partner was directly involved in the wrongful conduct or had knowledge of the wrongful conduct but failed to take reasonable steps to prevent it.

A few cases addressing the liability protection of partners in LLPs in other states have appeared, but there is nothing approaching a well-developed body of case law in this area. See *Ederer v. Gursky*, 826 N.Y.S.2d 210 (N.Y. A. D. 1 Dept. 2006) (stating NY LLP statute does not exempt partners from liability to account to withdrawing partner, and does not exempt partners for liability to withdrawing partner for breach of firm-related agreements between them); *Connolly v. Napoli, Kaiser & Bern, LLP*, 817 N.Y.S.2d 872 (N.Y. Sup. 2006) (noting potential liability of LLP partners for personal participation in alleged wrongdoing); *Groth v. Ace Cash Express, Inc.*, 623 S.E.2d 208 (Ga. App. 2005) (concluding signatures of LLP partners on behalf of partnership did not bind them individually as guarantors); *Colliers, Dow and Condon, Inc. v. Schwartz*, 871 A.2d 373 (Conn. App. 2005) (holding that LLP partner did not have personal liability on agreement executed by partner on behalf of LLP); *Dow v. Jones*, 311 F.Supp.2d 461 (D. Md. 2004) (rejecting argument that attempt to hold dissolved LLP with no assets liable was disguised attempt to pierce the LLP veil, and stating that action against the LLP served purpose because LLP was required to have insurance and action could establish claim for purposes of

coverage under policy); *Griffin v. Fowler*, 579 S.E.2d 848 (Ga.App. 2003) (denying LLP partners' motion for summary judgment regarding liability for another partner's alleged malpractice and breach of fiduciary duty on the basis that there were legal services performed prior to the partnership's registration as an LLP); *Dow v. Donovan*, 150 F.Supp.2d 249 (D. Mass. 2001) (refraining from deciding the "unsettled" question of what proof would be necessary to hold individual partners liable for Title VII gender discrimination claims); *Lewis v. Rosenfeld*, 138 F.Supp.2d 466 (S.D. N.Y. 2001), *dism'd* on other grounds on reconsideration, 145 F.Supp.2d 341 (S.D. N.Y. 2001) (acknowledging that partners in New York LLP could not be held vicariously liable for liabilities of the partnership when the plaintiff had not alleged that any of the tortious acts were committed by the defendants or any individual acting under their control); *Schuman v. Gallet, Dreyer & Berkey, L.L.P.*, 719 N.Y.S.2d 864 (N.Y. A.D. 1 Dept. 2001) (holding general release of LLP and partners was sufficient to release partner in his capacity as partner but did not release partner from negligence, breach of fiduciary duty, and legal malpractice alleged against partner individually because partner is liable for any negligent or wrongful act committed by partner or under partner's supervision or control under New York LLP provisions); *Kus v. Irving*, 736 A.2d 946 (Conn. Super. 1999) (concluding that two law firm partners who did not have any supervision or control over third partner/wrongdoer were protected from liability under Connecticut LLP statute, which protects partners from liability for partnership debts and obligations except for partner's own negligence, wrongful acts, or misconduct or that of any person under partner's direct supervision or control, even if there was evidence of violation of supervisory duty under Rule 5.1, because LLP statute supersedes the rule except where the other person is under the partner's "direct supervision and control"); *Middlemist v. BDO Seidman, LLP*, 958 P.2d 486 (Colo. App. 1997) (holding that LLP partner was protected from liability for wrongful termination claim and noting that a party seeking to hold a partner in a Colorado LLP liable for alleged improper actions of the partnership must proceed as if attempting to "pierce the corporate veil"). See also *Chamberlain v. Irving*, 2006 WL 3290446 (Conn. Super. 2006) (stating that partners in LLP have limited liability even if designator is not used and third party does not know partnership is LLP); *Cordier v. Tkach*, 2006 WL 2407051 (Cal. App. 2 Dist. 2006) (holding that partner in LLP could not be held liable on contract of firm entered while partnership was registered as LLP because partner was not party in his individual capacity and California LLP provisions insulated partner from liability under agreement); *Dean*

Foods Company v. Pappathanasi, 2004 WL 3019442 (Mass. Super. 2004) (concluding LLP as entity was liable for negligence and negligent misrepresentation based on legal opinion issued by firm, but negligence was entity's collective negligence, and no act of any individual partner standing alone was basis to hold individual partner liable); *Mantell v. Samuelson*, 4 Misc.3d 134(A), 2004 WL 1587555 (N.Y. Sup. App. 2004) (dismissing complaint against partners of LLP law firm in suit by court reporter to recover fees because partners in LLP are not liable for partnership debts); *Colliers, Dow & Condon, Inc. v. Schwartz*, 2004 WL 1246004 (Conn. Super. 2004) (concluding plaintiff was not entitled to judgment against LLP partner because partners in LLP are clearly protected from personal liability); *Rashti v. Miod*, 2003 WL 22995264 (Cal.App. 2003) (stating that issue of whether individual partner of LLP can be held liable for discriminatory action in which partner personally participated would appear to be unsettled in view of statutory language indicating partners may be liable in some situations, and concluding that action seeking to hold partners liable for employment discrimination claim could not be deemed frivolous where action was based on decision in which partner reputedly participated); *Megadyne Info. Sys. v. Rosner, Owens & Nunziato*, 2002 WL 31112563 (Cal.App. 2002) (concluding there were fact questions about extent of law firm LLP partners' involvement in matters that were subject of breach of fiduciary duty claim precluding summary judgment in favor of partners); *Liberty Mutual Ins. Co. v. Gardere Wynne, L.L.P.*, 1994 WL 707133 (D. Mass. 1994) (noting, in support of its decision to transfer venue to Texas, that there would be difficult issues under the Texas LLP statute governing the litigation of the merits of the case).

In some cases, courts have erroneously applied the rules regarding the limited liability of a limited partner in a limited partnership when analyzing the liability protection of a general partner in an LLP. See *United States v. 175 Inwood Assocs. LLP*, 330 F.Supp.2d 213 (E.D. N.Y. 2004) (holding that LLP provisions do not protect general partners from personal liability if partnership assets are insufficient to satisfy judgment, relying on non-LLP case law and mistakenly characterizing such case law as involving LLPs); *Schaufler v. Mengel, Metzger, Barr & Co., L.L.P.*, 745 N.Y.S.2d 291 (N.Y. Sup. 2002) (stating that defendants had submitted insufficient evidence to establish that managing partner of accounting firm had no liability as a matter of law on buy-out agreement negotiated with plaintiff partner because the limited partnership act imposes joint and several personal liability on a general partner and on a limited partner who participates in the control of the business); *Damaska v. Kandemir*, 760

N.Y.S.2d 842, withdrawn 2004 WL 852298 (N.Y. A.D. 1 Dept. 2003) (stating that “[a] partner in a limited liability partnership may be held liable for tortious conduct committed by another partner or individual working for the entity if the partner participates in the control of the business [citing *Schaufler v. Mengel, Metzger, Barr & Co., LLP*, and thereby perpetuating the confusion between a limited partnership and an LLP] or if the person for whose conduct the partner is called upon to answer was, at the time of the misconduct, rendering professional services on behalf of the partnership under the partner’s direct supervision and control”).

G. Limited Partnership LLP

A limited partnership may become an LLP by complying with the applicable provisions of Chapters 152, as modified by Chapter 153 of the BOC. *See* Bus. Org. Code §§ 152.805, 153.351-153.353. (A limited partnership’s registration as an LLP on or after January 1, 2006 is governed by the BOC even if the limited partnership was formed prior to 2006. Bus. Org. Code § 402.001(d). Prior to January 1, 2006, limited partnership LLP registrations were governed by the TRLPA and TRPA. *See* Tex. Rev. Civ. Stat. art. 6132b-3.08(e); art. 6132a-1, § 2.14.) Specifically, a limited partnership may register as an LLP by following the procedures specified in Chapter 152 of the BOC and in the partnership’s agreement or, if the partnership agreement does not contain provisions in this respect, with the consent of the partners required to amend the agreement. Bus. Org. Code § 153.351. A limited partnership must also comply with the insurance or financial responsibility requirements of Chapter 152. The BOC requires the name of a limited partnership registered as an LLP to contain the phrase “limited liability partnership” or “limited liability limited partnership,” or an abbreviation of one of those phrases, in addition to the required limited partnership designator. Bus. Org. Code § 5.055(b). (The TRLPA states that the partnership name must include “limited partnership” or “Ltd.” followed by “registered limited liability partnership,” “limited liability partnership,” “LLP,” or “L.L.P.” as the last words of its name.) When applying the registration requirements found in Chapter 152, an application by a limited partnership to become an LLP must be executed by at least one general partner, and all other references to partners mean general partners only. Bus. Org. Code § 153.352. The filing fee is \$200 per general partner. Bus. Org. Code §§ 4.155(12), 4.158(1). If a limited partnership is an LLP, the liability limitations of the LLP provisions apply to its general partners and to any limited partners who, under other provisions of the limited partnership statutes, are liable for the debts and

obligations of the limited partnership. Tex. Rev. Civ. Stat. art. 6132a-1, § 2.14(c); Bus. Org. Code § 153.353. Thus, if a limited partner would otherwise be liable for participating in the control of the partnership, the limited partner should be protected in an LLP limited partnership even though the creditor reasonably believed the limited partner was a general partner.

Currently, a substantial number of states do not expressly provide for limited partnership LLPs, and there is considerable variation among the statutes that do. Thus, the LLP shield of a limited partnership that has registered in Texas may not be recognized in all states. The new Uniform Limited Partnership Act (2001) (“ULPA 2001”), which is a complete revision of the prior Revised Uniform Limited Partnership Act (1976 with 1985 amendments), provides that a limited partnership may elect LLP status. ULPA 2001 has been adopted in twelve states.

Charging Orders

In some cases, a judgment creditor of a business owner may seek to reach the debtor's ownership interest in the business, perhaps with the aim of exercising control over the business and ultimately reaching the assets of the business itself. This may be a serious concern to other owners of the business. The judgment creditor of a shareholder may pursue remedies generally available to judgment creditors to obtain the shareholder's stock and thereby acquire all the rights associated with the stock, including voting rights. In contrast, a judgment creditor of a partner has historically been confined to pursuit of a charging order as a means to reach the partnership interest of the debtor partner. Under Section 28 of the old Uniform Partnership Act ("UPA"), a judgment creditor could pursue a charging order, in a potentially cumbersome judicial proceeding peculiar to partnerships, to obtain a sort of lien on the debtor's partnership interest. The charging order would entitle the judgment creditor to receive the debtor partner's share of any distributions made by the partnership, but gave the judgment creditor no right to participate in the management of the partnership. The UPA charging order provision implied that judicial foreclosure of the partnership interest could be pursued; therefore, the creditor might ultimately become an assignee of the interest through a forced sale, but the creditor still would not have a say in the management of the partnership or timing of distributions. There was case law under the UPA holding that the charging order constituted the exclusive remedy of a judgment creditor against the debtor's partnership interest.

The drafters of the Texas Revised Partnership Act ("TRPA") dispensed with the charging order provisions. A judgment creditor of a partner in a general partnership would now be entitled to use the remedies generally available to judgment creditors to reach intangible or contractual interests. Still the creditor should only be able to reach the economic interest, not rights to participate as a partner in management of the partnership. The Texas Revised Limited Partnership Act ("TRLPA") and Business Organizations Code ("BOC") retain the concept of a charging order, with the possibility of foreclosure and ancillary relief, and specifically provide that the charging order provisions are exclusive of other remedies. The Texas Limited Liability Company Act ("TLLCA") includes a charging order provision in article 4.06 under which a judgment creditor of a member may go to court and obtain a charging order with respect to the member's interest in the LLC. A similar provision is contained in Section 101.112 of the BOC. The LLC charging order provisions do not state whether the charging order is an exclusive remedy and are silent regarding foreclosure and redemption of the interest.

Some states, such as Delaware, have amended their charging order provisions to remove any reference to foreclosure, redemption, or ancillary relief, and to provide in very direct and explicit terms that the charging order remedy is the exclusive remedy of a judgment creditor of a partner or LLC member. Some lawyers consider the charging order to be an important consideration in the choice of entity analysis, especially if shielding the assets of the business entity from creditors of the business owners is a significant goal. Pending legislation would amend the charging order provisions of the Texas limited partnership and LLC statutes (both the BOC and pre-Code statutes) to read similarly to the Delaware provisions. Attached is a copy of the proposed amendments, which were added to H.B. 1737 at the request of Representative Gary Elkins. H.B. 1737 has passed the House and has been reported favorably out of the Business and Commerce Committee of the Senate.

SECTION 98. Section 101.112, Business Organizations Code, is amended to read as follows:

Sec. 101.112. MEMBER'S [~~JUDGMENT CREDITOR; CHARGE OF~~] MEMBERSHIP INTEREST SUBJECT TO CHARGING ORDER. (a) On application by a judgment creditor of a member of a limited liability company or of any other owner of a membership interest in a limited liability company, a court having jurisdiction may charge the membership interest of the judgment debtor to satisfy [~~member or owner, as appropriate, with payment of the unsatisfied amount of~~] the judgment.

(b) If a court charges a membership interest with payment of a judgment as provided by Subsection (a), the judgment creditor has only the right to receive any distribution to which the judgment debtor would otherwise be entitled in respect [~~rights of an assignee~~] of the membership interest.

(c) A charging order constitutes a lien on the judgment debtor's membership interest.

(d) The entry of a charging order is the exclusive remedy by which a judgment creditor of a member or of any other owner of a membership interest may satisfy a judgment out of the judgment debtor's membership interest.

(e) This section may not be construed to deprive a

~~to the limited partnership; and~~

~~[(3) make other orders, directions, and inquiries that the circumstances of the case require].~~

(b) To the extent that the partnership interest is charged in the manner provided by Subsection (a), the judgment creditor has only the right to receive any distribution to which the judgment debtor would otherwise be entitled in respect ~~[rights of an assignee]~~ of the partnership interest.

(c) A charging order constitutes a lien on the judgment debtor's ~~[The]~~ partnership interest ~~[charged may be:~~

~~[(1) redeemed at any time before foreclosure; or~~

~~[(2) in case of a sale directed by the court, and without constituting an event requiring winding up, purchased:~~

~~[(A) by one or more of the general partners with separate property of any general partner; or~~

~~[(B) with respect to partnership property, by one or more of the general partners whose interests are not charged, on the consent of all general partners whose interests are not charged and a majority in interest of the limited partners, excluding limited partnership interests~~

interest of the judgment debtor to satisfy [~~member or other owner with payment of the unsatisfied amount of~~] the judgment. To [~~Except as otherwise provided in the regulations to~~] the extent that the membership interest is charged in this manner, the judgment creditor has only the right to receive any distribution to which the judgment debtor would otherwise have been entitled in respect [~~rights of an assignee~~] of the membership interest.

B. A charging order constitutes a lien on the judgment debtor's membership interest.

C. The entry of a charging order is the exclusive remedy by which a judgment creditor of a member or of any other owner of a membership interest may satisfy a judgment out of the judgment debtor's membership interest.

D. This Section does not deprive any member or other owner of a membership interest of the benefit of any exemption laws applicable to the judgment debtor's [~~that member's~~] membership interest.

E. A creditor of a member or of any other owner of a membership interest does not have the right to obtain possession of, or otherwise exercise legal or equitable remedies with respect to, the property of the limited liability company.

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~~[(1) with separate property of any general partner, by any one or more of the general partners; or~~

~~[(2) with respect to partnership property, by any one or more of the general partners whose interests are not charged, on the consent of all general partners whose interests are not charged and a majority in interest of the limited partners, excluding limited partnership interests held by any general partner whose interest is charged].~~

(c) The entry of a charging order is the ~~[remedies provided by Subsection (a) of this section are]~~ exclusive remedy by which a judgment creditor of a partner or of any other owner of a partnership interest may satisfy a judgment out of the judgment debtor's partnership interest ~~[of others that may exist, including remedies under laws of this state applicable to partnerships without limited partners]~~.

(d) This section does not deprive any partner or other owner of a partnership interest of the benefit of any exemption laws applicable to the judgment debtor's ~~[that partner's]~~ partnership interest.

(e) A creditor of a partner or of any other owner of a partnership interest does not have the right to obtain possession of, or otherwise exercise legal or equitable remedies with respect to, the property of the limited