# CURRENT ISSUES IN USE OF
# (AND LITIGATION INVOLVING) LLCs

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## I. Introduction

Since the advent of limited liability companies (LLCs) in Texas in 1991, the LLC has become an immensely popular form of business. An LLC offers more flexibility than a corporation with respect to federal income tax treatment and structuring of management and ownership, while still providing owners liability protection comparable to the corporate form. The statistics regarding formation of corporations and LLCs in Texas in 2012 reveal the extent to which LLCs have become the entity of choice in Texas. In 2012, 22,918 new Texas for-profit corporations were formed, and 100,452 new Texas LLCs were formed. Furthermore, Texas LLCs have outnumbered Texas corporations for several years, and the margin is increasing each year. As of March 1, 2014, there were 359,764 active Texas for-profit corporations and 567,576 active Texas LLCs. Obviously, then, LLCs have become a significant part of the business entity landscape. This paper provides an overview of certain "hot topics" in the LLC context, with a view towards issues that are important to both the transactional and litigation attorney.

## II. Treatment of LLCs for Diversity Jurisdiction Purposes

A substantial body of case law has developed in the context of the determination of the citizenship of an LLC for diversity jurisdiction purposes, and federal courts have overwhelmingly concluded that an LLC is not "incorporated" within the meaning of the federal diversity jurisdiction statute. Federal courts that have confronted and analyzed the issue (in dozens of court of appeals decisions and hundreds of district court opinions) have been virtually unanimous in concluding that an LLC's citizenship is not determined in the same manner as a corporation's citizenship for purposes of diversity jurisdiction. A corporation is deemed to be a citizen of its state of incorporation and the state where its principal place of business is located. 28 U.S.C. § 1332(c)(1). However, based on the approach to citizenship applied by the United States Supreme Court to a limited partnership in *Carden v. Arkoma Associates,* 494 U.S. 185 (1990), federal courts have consistently held that an LLC has the citizenship of each of its members. *See, e.g., Pramco, LLC v. San Juan Bay Marina, Inc.*, 435 F.3d 51 (1st Cir. 2006); *Handelsman v. Bedford Vill. Assocs, L.L.C.*, 213 F.3d 48 (2d Cir. 2000); *Zambelli Fireworks Mfg. Co., Inc. v. Wood*, 592 F.3d 412 (3d Cir. 2010); *Gen. Tech. Applications, Inc. v. Exro Ltda*, 388 F.3d 114 (4th Cir. 2004); *Harvey v. Grey Wolf Drilling Co.*, 542 F.3d 1077 (5th Cir. 2008); *Delay v. Rosenthal Collins Grp., LLC*, 585 F.3d 1003 (6th Cir. 2009); *Cosgrove v. Bartolotta*, 150 F.3d 729 (7th Cir. 1998); *GMAC Commercial Credit LLC v. Dillard Dept. Stores, Inc.*, 357 F.3d 827 (8th Cir. 2004); *Johnson v. Columbia Props. Anchorage, LP*, 437 F.3d 894 (9th Cir. 2006); *Rolling Greens MHP, L.P. v. Comcast SCH Holdings L.L.C.*, 374 F.3d 1020 (11th Cir. 2004).

In *Carden*, the court rejected the argument that a limited partnership should be considered a citizen of its jurisdiction of formation or, alternatively, that only the citizenship of its general partners should be considered. 494 U.S. 185. The court refused to deviate from the established precedent of considering the citizenship of every member of an unincorporated entity. *Id.* The court acknowledged that its conclusion could "validly be characterized as technical, precedent-bound, and unresponsive to policy considerations raised by the changing realities of business organization," but left to Congress the task of "accommodating our diversity jurisdiction to the changing realities of commercial organization." *Id.* at 196-97. The court noted that Congress chose not to redefine how artificial entities other than corporations are treated under the diversity jurisdiction statute when it adopted the current dual citizenship rule for corporations in 1958. *Id.* at 196.The court recognized that the states would continue to create a wide assortment of artificial entities with different powers and characteristics but concluded that the manner in which the citizenship of these entities should be determined is a matter "more readily resolved by legislative prescription than by legal reasoning." *Id.* at 197. Thus, federal courts were essentially constrained by the United States Supreme Court to approach LLCs in this manner and to look to the citizenship of an LLC's members in determining citizenship for diversity purposes.

Some federal courts have grown impatient with parties who fail to appreciate the well-established difference between an LLC and a corporation for purposes of establishing citizenship in a diversity case, and a party increasingly risks incurring the court's wrath and harsh treatment for this oversight. *Belleville Catering Co. v. Champaign Marketing Place, L.L.C.*, 350 F.3d 691 (7th Cir. 2003) (criticizing counsel for parties in scathing terms for treating LLC as corporation for purposes of diversity jurisdiction and ordering counsel to perform remaining services required to resolve dispute without charging parties any attorney's fees); *Allstate Ins. Co. v. Santa Ana LLC*, No. 08-60865-CIV, 2008 WL 2404822 (S.D. Fla. June 11, 2008) (slip op.) (dismissing action for failure to adequately allege citizenship of LLC and echoing frustration of Seventh Circuit Court of Appeals regarding lawyers' lack of familiarity with diversity jurisdiction rules); *Sterling Wholesale, LLC v. Miami-McLane Trading Corp.*, No. 08-60867-CIV, 2008 WL 2404825 (S.D. Fla. June 11, 2008) (slip op.) (same); *Tilkin & Cagen, Inc. v. United Metal Receptacle Corp.*, No. 08 C 1564, 2008 WL 2339825 (N.D. Ill. June 4, 2008) (slip op.) (stating that nearly full decade had elapsed since Seventh Circuit Court of Appeals spelled out requirements for establishing diversity of citizenship when LLC is party and that disregard of such well-established rule by plaintiff's counsel should trigger automatic dismissal); *Lexington Ins. Co. v. Gilco Scaffolding Co., LLC*, No. 08 C 2634, 2008 WL 2035760 (N.D. Ill. May 12, 2008) (slip op.) (same); *MB Fin. Bank, N.A. v. DirechTech Holding Co., Inc.*, No. 08 C 2524, 2008 WL 1995057 (N.D. Ill. May 6, 2008) (slip op.) (same). Other courts are more tolerant as they point out the error in a party's assumption that an LLC is treated in the same manner as a corporation for purposes of diversity jurisdiction. *Realco Ltd. Liab. Co. v. AK Steel Corp.*, Civil Action No. 06-131-ART, 2008 WL 1990810 (E.D. Ky. May 5, 2008). In this case, the parties did not dispute the court's subject matter jurisdiction, but the court inquired on its own as to the citizenship of the plaintiff LLC's members. Disclosure by the plaintiff revealed that complete diversity was lacking based on the rule that an LLC has the citizenship of each of its members, and the court remanded the case to state court for lack of jurisdiction. The court noted that "[i]t is common in cases like this for one to assume that limited liability companies are no different than corporations, and, thus, the pleadings often allege only the place of incorporation and principal place of business." *Id.* at *1. The court pointed out that this is an incorrect assumption and that it is well-established that a limited liability company has the citizenship of its members. *Id.* The court acknowledged that "it may seem illogical at first blush to treat a limited liability company differently from a corporation," but stated that "it is the job of Congress, not the courts, to fix any inconsistencies this may cause." *Id.* at *2. The court concluded almost apologetically, stating: "The Court does not take this action lightly, as it realizes the burden this action imposes on the parties. As the Court is sure the parties recognize, jurisdiction is not something with which the Court has discretion. And, in this regard, the Court appreciates the parties' diligence and assistance in determining whether jurisdiction in this matter is appropriate." *Id.*

Determination of an LLC's citizenship can be complicated by the fact that the members of an LLC may themselves be LLCs or partnerships whose citizenship in turn is determined by the citizenship of their partners or members. When there are several layers of such entities or when the partners or members of a partnership or LLC are numerous, this determination may become very challenging. The challenging nature of establishing the citizenship of such a party does not excuse the obligation to do so when diversity of citizenship is relied on for subject matter jurisdiction. In *James v. Myers*, No. 12-dv-22-DRH-SCW, 2012 WL 525583 (S.D. Ill. Feb. 16, 2012), the defendants, which included an LLC, removed the action to federal court on the basis of diversity of citizenship. In the notice of removal, the defendants alleged only the state of formation and principal place of business of the LLC. Additional briefing revealed that the LLC's sole member was another LLC whose sole member was a limited partnership. No information as to the partners of the limited partnership was provided. The defendants argued that the fact that the limited partnership was an investment fund with tens of thousands of investors made it"virtually impossible" to allege the citizenship of each of its members. The defendants urged the court to look to the state of formation and principal place of business of the LLCs and the partnership to determine citizenship, but the court stated that the Seventh Circuit had made it "abundantly clear" that the court must consider the citizenship of all the members of the defendant LLC, through the parent LLC, through all the layers of ownership of the limited partnership until the court reached only individual human beings and corporations. Because the defendants admitted that it was "virtually impossible" to allege the citizenship of the limited partnership's members, the defendants failed in their burden to show complete diversity, and the court remanded the action to state court.

Many federal district courts are now raising *sua sponte* the issue of diversity of citizenship in cases in which an LLC is a party and insufficient information to establish diversity of citizenship has been pled. *See, e.g., Wildwood Capital Asset, LLC v. Westerfield*, No. 3:12-CV-370-L, 2013 WL 357611 (N.D. Tex. Jan. 30, 2013) (slip op.) *Pyramid Transp., Inc. v. Greatwide Dallas Mavis, LLC*, No. 3:12-CV-0149-D, 2013 WL 840664 (N.D. Tex. Mar. 7, 2013) (slip op.); *Murchison Capital Partners, L.P. v. Nuance Commc'ns, Inc.*, No. 3:12-CV-4746-L, 2013 WL 5990948 (N.D. Tex. Nov. 30, 2012) (slip op.).

It does not appear that Congress is inclined to step in and alter the approach taken by courts to an LLC's citizenship in regular diversity jurisdiction cases. In 2005, Congress amended the diversity jurisdiction statute with respect to class actions and included in these amendments a dual citizenship test for unincorporated associations in class action diversity cases (*see* 29 U.S.C. § 1332(d)(10)); however, Congress did not act to address the issue outside of the class action context.

## III. Piercing the Limited Liability Company Veil

### A. Piercing the LLC Veil to Impose Liability on a Member

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 Workers' Compensation Act). Of course, it is possible to "pierce the veil" of a corporation and hold a shareholder liable for a corporate debt under certain circumstances. Like the predecessor Texas Limited Liability Company Act ("TLLCA"), the LLC provisions of the Texas Business Organizations Code ("BOC") as originally enacted did 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 an obligation of the LLC. In 2011, the BOC was amended to provide that Sections 21.223-21.226, which include strict standards for piercing the corporate veil in a case arising out of a contract of the corporation, apply to LLCs.[1] *See* Tex. Bus. Orgs. Code § 101.002. One Texas commentator has argued that the statutory limitation of liability in the Texas LLC statute was intended to be absolute, i.e., that the legislature did not address veil piercing in the LLC statute because it did not intend for veil piercing to occur in the LLC context. *See* Byron F. Egan, *Choice of Entity Decision Tree After Margin Tax and Texas Business Organizations Code*, 42 TEX. J. BUS. L. 71, 173 (2007). Courts in Texas and other jurisdictions have thus far refused to hold that the statutory liability shield of an LLC is absolute, and the courts have predictably borrowed from the corporate veil-piercing jurisprudence in addressing LLC veil piercing.[2]

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[1] Legislation that would have incorporated by reference in the LLC statutes the standards from the corporate statutes was introduced in the 2009 legislative session. S.B. 1773 passed the Senate but died on the House calendar at the end of the session when the House process became stalled by a dispute over voter identification legislation. In the 2011 legislative session, a similar bill, S.B. 323, was passed by the legislature and signed by the governor. This bill became effective September 1, 2011.

[2] The LLC veil-piercing cases in jurisdictions other than Texas are too numerous to cite in this paper, but some of the cases are cited in Elizabeth S. Miller, *Are There Limits on Limited Liability? Owner Liability Protection and Piercing the Veil of Texas Business Entities*, 43 TEX. J. BUS. L. 405, 420-24 (2009). All state LLC statutes provide for limited liability of members, and some 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); Colo. Rev. Stat. Ann. § 7-80-107 (stating that courts shall apply case law interpreting the conditions and circumstances under which the veil of a corporation may be pierced but that the failure of an LLC to observe formalities or requirements relating to its management and affairs is not itself grounds to impose liability on members); Minn. Stat. § 322B.303 subd. 2 (providing that the case law stating the conditions and circumstances under which the veil of a corporation may be pierced applies to LLCs). In most states, as was the case in Texas until 2011, the statutes are silent regarding veil piercing. *See, e.g.*, 6 Del. Code Ann. § 18-303 (providing that a member or manager shall not be obligated personally for any LLC debt, obligation, or liability solely by reason of being a member or acting as a manager); Nev. Rev. Stat. §§ 86.371, 86.381 (providing that members have limited liability and are not proper parties in a proceeding against an LLC). Thus far, courts have recognized the concept of veil piercing in the LLC context regardless of whether the state LLC statute at issue addresses veil piercing.

If the Texas LLC statute does not reflect a legislative intent to preclude veil piercing, then the Texas courts are faced with determining the standards for piercing the LLC veil. Effective September 1, 2011, the BOC makes clear that a member may not be held liable for an obligation of the LLC arising out of a contract of the LLC unless the strict standards of Section 21.223 are met. Tex. Bus. Orgs. Code § 101.002. Further, failure of the LLC to follow any formality required by the BOC or its governing documents is not a basis to hold a member liable for any type of obligation of the LLC. *Id.* Even before the amendment of the BOC to incorporate by reference the provisions of Sections 21.223-21.226, courts in Texas defined the standards in the LLC context consistently with the corporate statutes in Texas when defining how veil piercing should apply to LLCs. *Shook v. Walden*, 368 S.W.3d 604 (Tex. App.—Austin 2012, pet. denied) (engaging in a thorough analysis of the common law standard applicable to an LLC veil-piercing claim arising before the addition of Section 101.002 of the BOC and concluding that courts should be guided by the corporate statutory standards rather than the more liberal standards articulated in *Castleberry v. Branscum*); *see also Fin & Feather Club v. Leander,* 415 S.W.3d 548 (Tex. App.–Texarkana 2013, pet. denied) (relying on *Shook v. Walden* for the proposition that the policies governing corporate veil piercing also apply to LLCs and concluding that there was no evidence of actual fraud to support piercing LLC veil); *Metroplex Mailing Servs., L.L.C. v. RR Donnelly & Sons Co.,* 410 S.W.3d 889 (Tex. App.–Dallas 2013, no pet.)(relying on *Shook v. Walden* for the proposition that the policies governing corporate veil piercing also apply to LLCs and holding that there was no evidence LLC was used to perpetrate actual fraud for the direct benefit of its sole member); *Doyle v. Kontemporary Builders, Inc.*, 370 S.W.3d 448 (Tex.App.–Dallas 2012, pet. denied) (discussing and applying case law and Section 21.223 of the BOC to claim that LLC was "sham corporation" as if LLC were corporation and concluding evidence was sufficient to support trial court's finding that LLC was not sole owner's alter ego); *Penhollow Custom Homes, LLC v. Kim,* 320 S.W.3d 366 (Tex.App.–El Paso 2010, no pet.) (discussing and applying corporate veil-piercing principles to LLC as if LLC were corporation and concluding that evidence owner took owner's draw rather than salary did not demonstrate lack of separateness between entity and owner, and jury's finding of alter ego could not stand); *In re HRM Holdings, LLC (Seidel v. Hosp. Res. Mgmt. LLC)*, 421 B.R. 244 (Bankr. N.D. Tex. 2009) (applying corporate veil-piercing principles in LLC context, noting that the TLLCA contained no analog to TBCA Article 2.21 but that "Texas courts and other jurisdictions have applied the same state law principles for veil-piercing that they have applied to corporations"); *In re JNS Aviation, LLC (Nick Corp. v. JNS Aviation, Inc.)*, 376 B.R. 500, 525-27 (Bankr. N.D. Tex. 2007) (determining that corporate veil-piercing principles apply to LLCs and citing Section 21.223 of the BOC for the proposition that a judgment creditor of an LLC must satisfy the statutory actual fraud standard to pierce the LLC's veil and hold its members liable for a judgment based on the LLC's breach of contract); *McCarthy v. Wani Venture, A.S.*, 251 S.W.3d 573, 590-91 (Tex.App.–Houston [1st Dist.] 2007, pet. denied) (rejecting the argument that the TLLCA creates an impenetrable liability shield, stating that cases in Texas and other jurisdictions have applied to LLCs the state law veil-piercing principles applied to corporations, and concluding that the trial court did not err in piercing the LLC veil to impose liability on an LLC member given the jury's finding of actual fraud in response to a jury charge based on the actual fraud standard in TBCA Article 2.21A(2)); *Pinebrook Props., Ltd. v. Brookhaven Lake Prop. Owners Ass'n,* 77 S.W.3d 487, 500-01 (Tex.App.–Texarkana 2002, pet. denied) (recognizing that the entity involved in the piercing analysis was an LLC and (without discussing whether or why corporate veil-piercing principles apply to LLCs) relying on corporate veil-piercing principles and TBCA Article 2.21A(3) for the proposition that failure to follow formalities is not a factor in determining alter ego); *K-Solv, LP v. McDonald*, 2013 WL 1928798 (Tex. App.–Houston [1st Dist.] May 9, 2013, no pet.) (noting that no party argued that BOC § 101.002 applied but that plaintiff conceded it must show actual fraud for members' direct personal benefit to pierce LLC's veil and hold members liable; holding that trial court correctly granted summary judgment in favor of members based on absence of evidence of essential element of direct personal benefit); *Roustan v. Sanderson*, 2011 WL 4502265 (Tex.App.–Fort Worth Dec. 1, 2011, pet. denied) (noting that courts apply to LLCs state law principles applied to pierce corporate veil and that fraud is basis to pierce veil but concluding claimants did not plead individual used LLC itself to perpetrate fraud and did not plead any other ground for disregarding corporate structure); *Watkins v. Basurto*, 2011 WL 1414135 (Tex. App.–Houston [14th Dist.] Apr. 14, 2011, no pet.) (recognizing that courts have applied corporate veil-piercing principles to LLCs but concluding evidence did not show unity between member and his LLCs or that injustice would result if member was not held liable); *Interplan Architects, Inc. v. C.L. Thomas, Inc.*, 2010 WL 4366990 (S.D. Tex. Oct. 27, 2010) (relying on actual fraud standard in corporate statutes in applying alter ego theory in LLC context and concluding plaintiff did not show LLC was formed for purpose of wrongful conduct); *Phillips v. B.R. Brick and Masonry, Inc.*, 2010 WL 3564820 (Tex.App.–Houston [1st Dist.] Sept. 10, 2010, no pet.) (noting that Texas has applied principles used to pierce corporate veil to LLCs and applying corporate veil-piercing cases in reviewing evidence (without reference to statutory veil-piercing standards because neither party argued that TBCA Article 2.21 or BOC Section 21.223 were applicable) and concluding evidence did not support piercing LLC veil to hold member liable to creditor of member's spouse); *In re Arnette (Ward Family Found. v. Arnette)*, 2011 WL 2292314 (Bankr. N.D. Tex. June 7, 2011) (noting that Texas has applied principles used to pierce corporate veil to pierce liability shield of LLC, discussing actual fraud standard of Section 21.223, and concluding evidence supported application of alter ego but not sham to perpetrate fraud); *In re Pace (Osherow v. Hensley)*, 2011 WL 1870054 (Bankr. W.D. Tex. May 16, 2011) (noting that "corporate veil piercing law is equally applicable in the context of limited liability companies" and stating that evidence showing member solely controlled LLC and commingled funds was probably insufficient to pierce veil under alter ego theory but evidence was sufficient to establish that member used LLC to perpetrate fraud where fraudulent transfer to LLC was involved). *In re Houston Drywall, Inc. (West v. Seiffert)*, 2008 WL 2754526 (Bankr. S.D. Tex. Jul. 10, 2008) (discussing and applying corporate veil-piercing principles as if LLC were corporation and concluding LLC in issue was "sham corporation"); *see also Prospect Energy Corporation v. Dallas Gas Partners, LP*, 761 F.Supp.2d 579 (S.D. Tex. 2011) (noting that Texas permits application of corporate veil-piercing principles to LLCs); *In re Williams*, 2011 WL 240466 (Bankr. W.D. Tex. 2011) (noting that Texas courts have applied statutory veil-piercing provisions applicable to corporations to LLCs); *In re Moore (Cadle Co. v. Brunswick Homes, LLC)*, 379 B.R. 284 (Bankr. N.D. Tex. 2007) (applying corporate reverse veil-piercing principles to Texas LLC and stating that whether an entity is a corporation or an LLC is a "distinction without a difference" for purposes of veil piercing); *Bramante v. McClain*, 2007 WL 4555943 (W.D. Tex. Dec. 18, 2007) (applying reverse corporate veil-piercing principles to various LLC defendants while speaking only in terms of corporations and without indicating whether the court realized that LLCs are not corporations); *Arsenault v.*

*Orthopedics Specialist of Texarkana*, 2007 WL 3353730 (Tex.App.–Texarkana Nov. 14, 2007, no pet.) (discussing corporate alter ego and single business enterprise theories and finding no factual basis in pleading or evidence supporting existence of alter ego or single business enterprise relationship between professional LLC and its owner for purposes of plaintiff's argument that service of expert report on entity constituted service on its owner).

In *Taurus IP, LLC v. DaimlerChrysler Corp.*, 534 F. Supp. 2d 849, 871-72 (W.D. Wis. 2008), the district court determined that TBCA Article 2.21 did not apply to a claim against an individual manager of a Texas LLC, but it appears the court was confused about the scope of the statute even with respect to corporations. The court did not believe that the statute limits alter ego liability of an individual who is an officer or director of a corporation but not a "shareholder or owner." *Id.* at 871. (The court did not address the fact that the statute protects "affiliates" of the shareholders and of the corporation as well as shareholders, thereby protecting affiliated entities and non-shareholder directors and officers of the corporation to the extent a veil-piercing theory might be relied upon to impose liability on such persons for a contractually related obligation of the corporation. *See Phillips v. United Heritage Corp.*, 319 S.W.3d 156 (Tex. App.–Waco 2010, no pet.) Thus, it is not clear whether the court in *Taurus* would have applied the statute by analogy to the LLC manager if it had properly understood the statute's application in the corporate context.

In *Shook v. Walden*, 368 S.W.3d 604 (Tex. App.—Austin 2012, pet. denied), the Austin Court of Appeals engaged in a thorough analysis of the common law standard applicable to an LLC veil-piercing claim arising before the addition of Section 101.002 of the BOC and concluded that courts should be guided by the corporate statutory standards rather than the more liberal standards articulated in *Castleberry v. Branscum*. The court of appeals in *Shook* noted the Wisconsin district court's opinion in *Taurus* and disagreed with that opinion. A dissenting justice in *Shook* argued that the equitable standard set forth in *Castleberry* should apply given the absence of a statutory standard.

From a policy standpoint, there is no apparent reason for courts to adopt common law veil-piercing doctrines that provide less liability protection for an LLC member than that available to a corporate shareholder. Indeed, to the extent that courts have distinguished at all between the application of veil-piercing principles in the corporate and LLC context, they have generally indicated that certain factors that could lead to piercing the veil of a corporation may merit less consideration in the LLC context. *See, e.g., FILO America, Inc. v. Olhoss Trading Company, LLC*, 321 F. Supp. 2d 1266, 1269-70 (M.D. Ala. 2004) (concluding that it is possible to pierce the LLC veil under Alabama law and that the plaintiff stated a claim to pierce the defendant LLC's veil by alleging the members had a fraudulent purpose in the conception of their business, but noting that some factors applied in corporate veil piercing may not apply to LLCs in the same manner they apply to corporations); *In re Giampietro (AE Restaurant Assocs., LLC v. Giampietro)*, 317 B.R. 841, 848 n.10 (Bankr. D. Nev. 2004) (commenting that the factors analyzed under the corporate alter ego doctrine may carry less weight in the LLC context and that domination by an owner may not justify piercing because LLC statutes allow members to manage the LLC and illustrate a legislative intent to allow small, one-person, and family-owned businesses the freedom to operate their companies themselves and still enjoy protection from personal liability); *Kaycee Land and Livestock v. Flahive*, 46 P.3d 323, 328 (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 the precise application of the factors may differ based upon the inherently flexible and informal nature of LLCs); *D.R. Horton Inc.-New Jersey v. Dynastar Development*, *L.L.C*., 2005 WL 1939778 at *33-36 (N.J. Super. L. Aug. 10, 2005) (agreeing with judicial opinions and commentators that have concluded LLC veil-piercing law should be adapted to the special characteristics of LLCs and identifying adherence to corporate formalities, dominion and control by the owner, and undercapitalization as factors that should "not loom as large" in the LLC veil-piercing analysis as they do in the corporate context).

As mentioned above, even before the BOC was amended to add Section 101.002, Texas courts relied upon corporate veil-piercing principles when presented with the question of whether to pierce the LLC veil. 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.

In *McCarthy v. Wani Venture, A.S.*, 251 S.W.3d 573 (Tex.App.–Houston [1st Dist.] 2007, pet. denied), the court of appeals rejected the argument that the TLLCA creates an impenetrable liability shield. The plaintiff sought to hold the defendant, a one-third member of a Texas LLC, liable for purchases made by the LLC from the plaintiff. The defendant argued that the LLC veil is impenetrable because the TLLCA does not address whether or under what circumstances a litigant may pierce the veil of an LLC. The court disagreed, stating that courts in Texas and other jurisdictions have applied to LLCs the same state law principles for veil piercing that are applicable to corporations. The jury charge included a question that inquired whether the defendant caused the LLC to be used to perpetrate an actual fraud, and did perpetrate an actual fraud upon the plaintiff, primarily for her own direct personal benefit (i.e., tracking the veil-piercing provision of Article 2.21A(2) of the TBCA). The jury answered this issue in the affirmative and found damages based on unpaid invoices owed by the LLC to the plaintiff. The court of appeals found the evidence sufficient to support the jury's verdict. A dissenting justice did not challenge the proposition that corporate veil-piercing principles apply to Texas LLCs, but disagreed with the majority that the evidence was sufficient to support the jury's finding that the defendant caused the LLC to perpetrate a fraud primarily for her direct personal benefit.

In the case of *In re HRM Holdings, LLC (Seidel v. Hospital Resources Management LLC)*, 421 B.R. 244 (Bankr. N.D. Tex. 2009), the bankruptcy court applied corporate veil-piercing standards in the LLC context, noting that "Texas courts and other jurisdictions have applied the same state law principles for veil-piercing that they have applied to corporations." The bankruptcy trustee sought to pierce the debtor LLC's veil and hold several affiliated LLCs liable as a single business enterprise based on actual fraud consisting of the debtor LLC's failure to notify creditors that it was terminating its business operations. (The trustee's first complaint had simply asserted the single business enterprise theory as a basis of liability without specifying fraud, and the court had allowed the trustee to replead and allege fraud as required by the corporate veil-piercing statutes.) According to the second amended complaint, the management of the LLC engineered the transfer of all the debtor LLC's assets to the defendant LLCs without notifying the creditors of the debtor LLC. The court concluded that the failure to give the statutorily required notice of winding up could constitute actual fraud under the Texas veil-piercing statutes, but the court found that the complaint failed to specify who the perpetrators of the fraud were and how the fraud benefitted the defendants. The court gave the trustee a final opportunity to further amend its complaint and admonished the trustee to examine the Texas veil-piercing statutes and the *SSP Partners* case when and if deciding to draft a third amended complaint.

In the case of *In re JNS Aviation, LLC (Nick Corp. v. JNS Aviation, Inc.)*, 376 B.R. 500 (Bankr. N.D. Tex. 2007), a bankruptcy court applying Texas law rejected the argument that a member's statutory liability protection under the Texas LLC statute precludes veil piercing and followed Texas cases that have applied corporate veil-piercing principles to LLCs. The court undertook a lengthy discussion of various veil-piercing theories under Texas law and found that the facts satisfied certain factors associated with several theories, but concluded that the facts best fit within the "sham to perpetrate a fraud" doctrine. The court found that shutting down the LLC without notice to the creditor (as required by the winding up provisions of the LLC statute), allowing the creditor to take a default judgment against the LLC, and distributing the LLC's assets to the owners who contributed the assets to a newly formed entity, was a scheme to isolate the judgment in a shell entity and constituted an actual fraud for the personal benefit of the owners of the entities.

In *Genssler v. Harris County*, __ S.W.3d. __, 2010 WL 3928550 (Tex.App.–Houston [1st Dist.] 2010, no pet.), the court analyzed the claim that an individual was liable for environmental violations committed by a group of entities that owned and operated two waste water facilities. Harris County and the State of Texas had obtained a receivership over the individual's property on the theory that the individual was the alter ego of the entities. The designators in the names of the entities indicate that the group of entities consisted of a limited partnership, two limited liability partnerships, and a limited liability company, but the court did not specify or discuss the nature of the entities. The court spoke in general terms about the separate legal existence of a "business entity" and the application of the alter ego theory when "there is such unity between the business entity and the individual that the business entity has ceased to be a separate entity, and allowing the individual to avoid liability through the use of the business entity would work an injustice." The court analyzed the evidence and concluded the entities were not the individual's alter ego because there was no evidence he diverted profits for his individual use, owned any interest in the entities, or personally paid any debts owed by the entities. There was testimony that the individual was the president, the "man in charge," and "made all the decisions," but the court stated that the individual's status as an officer or director, standing alone, was insufficient to support application of the alter ego theory.

In *Penhollow Custom Homes, LLC v. Kim,* 320 S.W.3d 366 (Tex.App.–El Paso 2010, no pet.), the court discussed and applied corporate veil-piercing principles to an LLC as if the LLC were a corporation and concluded that the jury's alter ego finding could not stand. The court concluded that there was no evidence of such unity between the LLC and its owner that the separateness of the LLC had ceased. Neither the owner's complete control over the entity nor the owner's practice of taking an owner's draw (requiring payment of quarterly estimates to the IRS) rather than a salary (which would be subject to withholding for federal income tax and medicare tax purposes) demonstrated a lack of separateness between the entity and its owner, and the court thus did not have to reach the question of whether the evidence was sufficient to prove that the owner used the LLC for the purpose of perpetrating an actual fraud for his direct personal benefit.

In *Doyle v. Kontemporary Builders, Inc.*, 370 S.W.3d 448 (Tex.App.–Dallas 2012, pet. denied), the court discussed and applied case law and Section 21.223 of the BOC to the plaintiff's claim that an LLC was a "sham corporation" and that its sole owner was its alter ego. The court noted that mere control and ownership of all of the stock of a corporation is not sufficient to ignore the distinction between the corporation and its shareholder. There was no evidence that the LLC was organized as a mere tool or business conduit of the owner, nor was any evidence that the LLC's property was not kept separately from the owners or that the LLC was used for personal purposes. Thus, the trial court did not err in finding that the owner was not the alter ego of the LLC.

In *Fin & Feather Club v. Leander,* 415 S.W.3d 548 (Tex. App.–Texarkana 2013, pet. denied), the court relied on *Shook v. Walden* for the proposition that the policies governing corporate veil piercing also apply to LLCs and held that there was no evidence of actual fraud, i.e., no evidence of dishonesty of purpose or intent to deceive, so as to hold a member or manager of the LLC liable. The court held that there was no evidence of the identity of the principals of the LLC but noted that the legislature specifically authorized single-member LLCs and limited the liability of a member or manager. Even if there had been evidence to establish that there was only one principal of the LLC, there was no evidence of actual fraud to support holding him liable and thus no basis to hold the sole principal liable for the LLC's debt.

In *Metroplex Mailing Services, L.L.C. v. RR Donnelly & Sons Company,* 410 S.W.3d 889 (Tex. App.–Dallas 2013, no pet.), the court held that there was no evidence to support piercing an LLC's veil to hold the sole member liable for the return of a deposit owed by the LLC. The court noted that the legislature specifically authorized single-member LLCs and that the statutory liability protection afforded members and managers only gives way when a plaintiff can show that the LLC was used for the purpose of perpetrating and did perpetrate an actual fraud for the member's or manager's direct personal benefit. The court relied on *Shook v. Walden* for the proposition that the policies governing corporate veil piercing also apply to LLCs and equated actual fraud to dishonesty of purpose or intent to deceive. The court concluded that the member's "use of a single-member LLC, as statutorily authorized by the legislature, combined with an ordinary personal loan to purchase equipment for the company's use secured by that equipment, amounts to no evidence of actual fraud even in combination with" other facts in the case. Even assuming the evidence showed that the LLC used some of the deposit as operating funds in violation of its agreement with the plaintiff and without disclosing the fact to the plaintiff, the court stated that there was no evidence that this action resulted in any direct personal benefit to the LLC's member. Additionally, although the member shut down the LLC in the face of the plaintiff's demand for its deposit (which the LLC was not yet obligated to return), the evidence showed that the LLC shut down due to declining business and not to avoid returning the deposit.

In *Spring St. Partners-IV, L.P. v. Lam*, 750 F.3d 427 (5th Cir. 2013), the Fifth Circuit Court of Appeals pointed out that the legislature specified that the BOC provisions regulating and restricting veil piercing of corporations are applicable to LLCs and their members and managers by adding Section 101.002 to the BOC in 2011and that the court of appeals in *Shook v. Walden* held that a plaintiff seeking to pierce the veil of an LLC not covered by BOC Section 101.002 must also meet the same requirements applicable to a corporation. These requirements differ depending upon whether a claimant is seeking to recover based on a tort or a contract. The claimant in this case sought to recover based on a fraudulent transfer of assets to an LLC, and the claimant argued that it was not required to prove actual fraud to pierce the LLC veil because fraudulent transfer of assets is a tort under Texas law. The court concluded that it did not have to determine whether the claimants were required to prove actual fraud or merely constructive fraud because there was "ample evidence" of the members' actual fraud. This evidence included the formation of an LLC ten days after the members' brother received notice that his debts were being accelerated, transfer of the brother's interest in another LLC to the newly formed LLC for no consideration, signing a document transferring an asset of the newly formed LLC to another family member for no consideration, failing to disclose the transfer for over a year during the pendency of litigation against the newly formed entity, attempting to evade the Texas Uniform Fraudulent Transfer Act by allowing the new LLC's charter to lapse, and attempting to evade individual liability by claiming the charter had been reinstated. The court stated that the members were acting for their direct personal benefit with respect to these actions because they had no other interest to serve.

In *Roustan v. Sanderson*, 2011 WL 4502265 (Tex. App.–Ft. Worth Sept. 29, 2011, pet. denied), the court held that the plaintiffs did not plead or prove a ground for ignoring the limitation of liability afforded in LLCs and did not allege that the limitation should be disregarded to hold Roustan, the president of the LLC's managing member, liable for the LLC's breach of contract. The court noted that courts apply to LLCs the state law principles applied to pierce the corporate veil, and fraud is a ground for disregarding the corporate form. The plaintiffs pled that Roustan fraudulently induced them to enter a contract, but they did not plead that Roustan used the LLC itself to perpetrate a fraud and that the entity should be disregarded to hold Roustan personally liable, and they did not plead any other ground for disregarding the corporate structure.

In *Watkins v. Basurto*, 2011 WL 1414135 (Tex. App.–Houston [14th Dist.] Apr. 14, 2011, no pet.), Basurto sued Watkins for personal injuries suffered in an assault by bouncers at a bar known as The Tavern. Two LLCs (which were not defendants) were involved in the operation of The Tavern. The trial court found that Watkins was liable for negligent hiring and supervision and as the alter ego of the LLCs operating The Tavern. The court recognized that members and managers of an LLC are not liable for judgments against the LLC but that courts have applied corporate veil-piercing principles to LLCs. Thus, an LLC member may be held individually liable for obligations of the LLC if the LLC is the mere alter ego of the member. The court concluded that there was insufficient evidence that unity existed between Watkins and the entities that operated The Tavern or that injustice would result if Watkins was not held liable. Basurto presented no evidence that Watkins mingled his personal property with that of the companies or that he used either company for personal purposes. The record did not show the extent of Watkins' ownership interest, but the evidence did show he exercised extensive control. However, mere control is insufficient to impose liability. Basurto also presented no evidence of failure to follow corporate formalities, so the court said it was not necessary to determine if corporate formalities remain a factor to be considered in piercing the LLC veil, noting that a corporate shareholder cannot be held liable on the basis of failing to follow corporate formalities. Finally, Basurto argued that the entities could not have satisfied his judgment, but he failed to present any evidence to support this argument.

In *Phillips v. B.R. Brick and Masonry, Inc.*, 2010 WL 3564820 (Tex.App.–Houston [1st Dist.] Sept. 10, 2010, no pet.), the creditor of an individual obtained a favorable veil-piercing verdict against the individual's spouse based on her operating of an LLC of which the spouse was the sole member. The jury charge included three corporate veil-piercing theories: alter ego, evading an existing obligation, and sham to perpetrate a fraud. The court noted that Texas has applied corporate veil-piercing principles to LLCs, and the court applied corporate veil-piercing cases in reviewing the sufficiency of the evidence to support the verdict. Because neither party argued that TBCA Article 2.21 or BOC Section 21.223 were applicable, the court stated that it would review the sufficiency of the evidence solely with reference to the jury instruction (there having been no objection to the instruction in the trial court). The court concluded that the evidence did not support piercing the LLC veil to hold the member liable to the creditor of the member's spouse. Although there was evidence that the member's spouse improperly used the LLC to avoid paying his obligation to the creditor, there was no evidence that the member or the LLC had any obligation to the creditor, and there was no evidence that the member was acting as the LLC's alter ego, used the LLC to avoid any obligation she had to the creditor, or acted with "dishonesty of purpose or intent to deceive."

In *In re Arnette (Ward Family Foundation v. Arnette)*, 2011 WL 2292314 (Bankr. N.D. Tex. June 7, 2011), the debtor was the president, sole shareholder, and sole decision maker of a corporation and the sole member and sole decision maker of an LLC. The plaintiff in this adversary proceeding sought to hold the debtor liable for claims against the entities under veil-piercing theories. The plaintiff asserted fraud, breach of contract, and various other claims against the debtor and his entities in connection with over $1.7 million lent to the entities by the plaintiff. The court noted that Texas has applied the principles used to pierce the corporate veil to pierce the liability shield of an LLC, and the court applied the same standards to the corporation and LLC in this case. First the court addressed the question of whether the actual fraud standard of Section 21.223 of the BOC applied to the claims in this case, i.e., whether the claims were tort claims outside the scope of the statute or were based on a contractual obligation of the entities. The court concluded that the plaintiff had satisfied the actual fraud standard assuming it applied. The court stated that "actual fraud" within the meaning of the statute is not the same as the common law tort of fraud and simply requires proof of dishonesty of purpose or intent to deceive. The court described how the debtor was dishonest in his dealings with the plaintiff and intended to mislead the plaintiff in order to induce the plaintiff to invest in the debtor's entities. The court also had no doubt that the debtor used the entities to perpetrate a fraud that primarily served to directly benefit him. The court did not, however, find that the sham to perpetrate a fraud theory applied in this case because neither of the debtor's entities were resorted to as a means of evading an existing legal obligation. Both entities existed before the plaintiff invested, and the debtor did not transfer assets among his companies with the purpose of using the corporate form to shield those assets from creditors. The court did conclude that the evidence supported a finding of alter ego based on evidence that included a showing of blended finances of the debtor and his two entities, sole ownership and control by the debtor of the entities, commingling of funds of the entities with his personal funds, the debtor's taking of loans and distributions to fund his lifestyle rather than any regular salary, and occasional use of the entities for personal purposes without proper documentation. The court also found that the plaintiff proved that the debtor defrauded the plaintiff through the entities and that the entities were out of business and had no assets to satisfy a judgment.

In *In re Williams*, 2011 WL 6180060 (Bankr. W.D. Tex. Dec. 11, 2011), the plaintiffs sought to establish that their claim against the debtors, Norman and Joan Williams, was nondischargeable. Norman and Jean Williams were the sole owners, managers, and employees of Williams Building Consultants, LLC, and the plaintiffs' claim was based on the breach of a construction contract between the LLC and the plaintiffs. The court concluded that the plaintiffs had a breach of contract claim against the debtors even though the contract was with their LLC. The court stated that the debtors completely disregarded the corporate form throughout the negotiations and closing process and that the LLC was "essentially a sham corporation." The LLC had no employees, no significant assets, and very little money in the bank. Mrs. Williams testified the LLC was created for the sole purpose of building the home purchased by the plaintiffs. The LLC did not file separate tax returns from the debtors. The debtors consistently referred to their home building business in terms of "we" rather than the LLC. The plaintiffs always understood the debtors to be the sellers of the property rather than the LLC. On this basis, the court allowed the plaintiffs' claim against the debtors. The court determined that the debt was dischargeable, rejecting the plaintiffs' argument that the debt was based on false pretenses, false representations, or actual fraud of the debtors.

In *In re Pace (Osherow v. Hensley)*, 2011 WL 1870054 (Bankr. W.D. Tex. May 16, 2011), the court determined that the transfer of a condominium from the debtor's corporation to an LLC owned by Hensley, a friend of the debtor, was a fraudulent transfer. The court then proceeded to analyze whether Hensley was jointly and severally liable with his LLC under veil-piercing theories. The court relied upon corporate veil-piercing principles, noting that "corporate veil piercing law is equally applicable in the context of limited liability companies." The court stated that the evidence showed that Hensley solely controlled the LLC and commingled funds but stated that this evidence was probably insufficient to pierce the veil under an alter ego theory. Nevertheless, the court found the evidence sufficient to establish that Hensley used the LLC to perpetrate a fraud. The court based this conclusion on its previous finding that Hensley did not act in good faith in connection with the transfer of the condo and helped the debtor carry out a fraudulent transfer. Therefore, Hensley was jointly and severally liable with the LLC.

In *Interplan Architects, Inc. v. C.L. Thomas, Inc.*, 2010 WL 4366990 (S.D. Tex. Oct. 27, 2010), the court relied on the actual fraud standard in Section 21.223 of the BOC in applying the alter ego theory in the LLC context and concluded the plaintiff did not show that the LLC was formed for the purpose of wrongful conduct.

In *In re Houston Drywall, Inc. (West v. Seiffert)*, 2008 WL 2754526 (Bankr. S.D. Tex. Jul. 10, 2008), the bankruptcy court concluded that an LLC general partner of a limited partnership was a "sham corporation," and that the individuals in control of the LLC were thus personally liable for breaches of fiduciary duties as general partners of the limited partnership. Although the court identified and referred to the general partner as a limited liability company in reciting the facts earlier in the opinion, the court discussed and applied corporate veil-piercing principles to the LLC as if it were a corporation.

The bankruptcy court in *In re Supplement Spot, LLC (Floyd v. Option One Mortgage Corporation)*, 409 B.R. 187 (Bankr. S. D. Tex. 2009) discussed and applied corporate case law as if the debtor, a Texas LLC, were a corporation, and the court characterized as "individual piercing" (although the result was actually consistent with traditional piercing) its conclusion that an account held in the name of the LLC debtor's president was property of the LLC. In this case, the bankruptcy trustee brought an action to avoid payments that were made from an account funded by the debtor LLC's business operations. The account was styled "Marcella Ortega dba Young Again Nutrients," and Marcella Ortega was president of the debtor LLC. The payments challenged by the trustee were payments on mortgage debts of Ortega, and the court held that they were avoidable as fraudulent transfers. In order to find that the payments were fraudulent transfers, the court had to find that the account was the property of the debtor LLC. The court found that the account was properly considered property of the LLC because the court could pierce the "individual veil" and view the account as property of the LLC. The court explained that a court may sometimes "pierce the corporate veil" to determine whether the activities and property of a corporation should be attributed to its individual principal or principals, but stated that the court here was being asked to do the opposite– to "pierce the individual veil" and attribute property of Ortega to the debtor LLC. The court noted that courts generally protect the individual assets from the reach of a corporation's bankruptcy, but cited the corporate alter ego doctrine as a basis to treat individual property as corporate property. The court stated that it would treat the account as property of the LLC because Ortega herself disregarded the separation between the LLC's funds and her funds by using the account exclusively to pay her personal expenses when the account was funded exclusively by the LLC's business. Further, the court noted that injustice would result if the account were not treated as the property of the debtor because the fraudulent transfers, if not avoided, would seriously hinder the trustee's ability to administer the bankruptcy case.

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. *See also Arsenault v. Orthopedics Specialist of Texarkana*, 2007 WL 3353730 (Tex.App.–Texarkana Nov. 14, 2007, no pet.) (finding no pleading or evidence supporting alter ego and single business enterprise veil-piercing claims against owner of professional LLC).

Courts in other jurisdictions have generally relied on corporate veil-piercing principles in the LLC context. *See, e.g., NetJets Aviation, Inc. v. LHC Commc'ns, LLC*, 537 F.3d 168, 178-84 (2d Cir. 2008) (stating Delaware corporate veil-piercing principles apply to LLCs and concluding questions of whether single member LLC was operated as alter ego of its member and whether LLC was operated with overall element of injustice or unfairness were questions for factfinder at trial); *Kaycee Land and Livestock v. Flahive*, 46 P.3d 323, 327-28 (Wyo. 2002) (concluding no legal or policy reason exists to distinguish LLCs from corporations for purposes of veil piercing but acknowledging precise application of factors may differ based on inherently more flexible and informal nature of LLCs). For additional cases in other states that have addressed veil piercing of LLCs, see Elizabeth S. Miller, *More Than a Decade of LLP and LLC Case Law: A Cumulative Survey of Cases Dealing With Limited Liability Partnerships and Limited Liability Companies*, June 2007, and subsequent case law updates available on the author's profile page at http://www.baylor.edu/law.

### B. Piercing the LLC Veil in the Personal Jurisdiction Context

Piercing the LLC veil is also addressed in a number of cases involving a court's exercise of personal jurisdiction. *See, e.g., Mt. McKinley Ins. Co. v. Grupo Mexico, S.A.B. De C.V.*, 2013 WL 1683641 (Tex. App.–Corpus Christi 2013, no pet.); *Haferkamp v. Grunstein*, 2012 WL 1632009 (Tex. App.–Eastland 2012, pet. denied); *Gonzalez v. Lehtinen*, 2008 WL 668600 (Tex.App.– Corpus Christi 2008, pet. denied); *Wolf v. Summers-Wood, L.P.*, 214 S.W.3d 783 (Tex.App.–Dallas 2007, no pet.); *Morris v. Powell*, 150 S.W.3d 212 (Tex.App.–San Antonio 2004, no pet.); *Stauffacher 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.); *Breckenridge Enters, Inc. v. Avio Alternatives, LLC*, 2009 WL 1469808 (N.D. Tex. 2009) *Taurus IP, LLC v. DaimlerChrysler Corp.*, 519 F.Supp.2d 905 (W.D. Wis. 2007); *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 Props., LLC,* 274 F.Supp.2d 1293 (S.D. Ala. 2003); *XL Vision, LLC v. Holloway*, 850 So.2d 1063 (Fla. App. 2003); *Int'l 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.) Sec., Futures & Options, Inc. v. Bingham Inv. Fund, L.L.C.*, 934 F.Supp. 987 (N.D. Ill.1996). The Texas Supreme Court's analysis of the distinction between "jurisdictional piercing" and "substantive piercing" presumably applies as well in the LLC context. *See PHC-Minden, L.P. v. Kimberly-Clark Corp.*, 235 S.W.3d 163 (Tex. 2007).

## C. Reverse LLC Veil Piercing

"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 recognized in some cases in Texas and other states.

A judgment creditor sought to reverse pierce the veil of an LLC to impose liability on the LLC for the creditor's judgment against an individual debtor in the case of *In re Moore (Cadle Company v. Brunswick Homes, LLC)*, 379 B.R. 284 (Bankr. N.D. Tex. 2007). The court discussed the development of both traditional and reverse corporate veil-piercing under Texas law and concluded that the doctrine of reverse veil piercing is applicable under Texas law although the doctrine has "rather thin roots" in Texas. Noting that neither the Texas Supreme Court nor the Texas legislature has opined on reverse veil piercing, the court relied upon Fifth Circuit case law that has recognized the doctrine under Texas law. The court, however, was troubled by the fact that the doctrine of reverse piercing has evolved and been accepted into the mainstream of Texas veil-piercing jurisprudence at the same time the Texas legislature has been limiting traditional veil piercing and without meaningful discussion of what the doctrine in substance accomplishes. The court concluded that the concept should be applied only when it is clear that it will not prejudice non-culpable shareholders or other stakeholders (such as creditors) of the corporation. The court applied corporate veil-piercing principles to the LLC in issue, stating that whether an entity is a corporation or an LLC is a "distinction without a difference" for purposes of veil piercing. The fact that reverse piercing was sought with respect to an individual who was not a record or nominal equity owner of the LLC did not preclude the claim since the plaintiffs sought to establish that the individual had a *de facto* interest in the LLC. The court concluded that fact issues precluded summary judgment for the LLC on the reverse veil-piercing claim and a claim for constructive trust on the LLC's assets. The court held that the ten-year statute of limitations for enforcement of a judgment applied to the reverse alter ego and constructive trust claims since the claims were being pursued to collect a judgment.

In *Bramante v. McClain*, 2007 WL 4555943 (W.D. Tex. Dec. 18, 2007), the plaintiffs, judgment creditors of an individual, sought to reverse pierce numerous LLCs on the basis that the LLCs were the alter egos of the individual under Texas veil-piercing principles. The LLCs sought summary judgment, arguing that there was no evidence of unity between the LLCs and the individual because the plaintiffs could not show that the individual had an ownership interest in, or control over, the LLCs. The court, however, found that the plaintiffs raised a fact question based on summary judgment evidence that the individual created a group of entities that ultimately became the LLC defendants in the case. Evidence that the individual was the sole owner of the entities that ultimately became the LLC defendants constituted evidence sufficient to raise a fact question regarding the individual's ownership and control of the LLCs. The court also found that the plaintiffs had raised a fact question as to whether the individual judgment debtor used entities owned by him to fraudulently transfer assets to the LLCs. Further, the court concluded that the plaintiffs stated a claim against the LLCs for conspiring by agreement to commit fraudulent transfers to avoid collection on the judgment. The court found no authority, however, supporting liability beyond the amounts actually transferred. *See also In re Juliet Homes, L.P.*, 2011 WL 6817928 (Bankr. S.D. Tex. Dec. 28, 2011) (concluding allegations adequately stated claim for reverse veil piercing under Texas law where trustee sought to count assets of non-debtor entities as assets of their owner-debtors for purposes of asserting fraudulent and preferential transfer claims against the non-debtor entities).

As amended in 2007, the charging order provision of the LLC statute provides that "[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." Tex. Bus. Orgs. Code § 101.112(f); *see also* Tex. Rev. Civ. Stat. art. 1528n, art. 4.06E (expired eff. Jan. 1, 2010). This provisions might be interpreted to preclude reverse piercing of a Texas LLC by a member's creditor. On the other hand, a creditor of an LLC member could presumably still resort to the fraudulent transfer statutes to recover property fraudulently transferred to the LLC, and it might similarly be argued that disregard of the LLC's separate existence under reverse piercing principles is not precluded by the charging order provision.

Cases applying reverse piercing principles in the LLC context in other jurisdictions include *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); *In re Schwab*, 378 B.R. 854 (Bankr. D. Minn. 2007). *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).

## IV. Direct Liability of LLC Members and Managers

In some situations, LLC members or managers may have direct liability based on common law principles or statutory provisions. In such cases, it is not necessary to "pierce the LLC veil" to hold the member or manager liable. A few such situations are discussed below.

### A. Liability for Committing or Knowingly Participating in Tortious or Fraudulent Acts

It is well-established that corporate officers may be held personally liable when they commit or knowingly participate in tortious or fraudulent acts even though the conduct occurred while the officer was acting on behalf of the corporation. *See, e.g., 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). Similarly, Texas courts have held that LLC members and managers are liable for their own fraudulent or tortious acts even if the acts are committed in the service of the LLC. *See Nwokedi v. Unlimited Restoration Specialists*, __ S.W.3d __, 2014 WL 258993 (Tex.App.–Houston [1st Dist.] 2014, pet. filed) (holding controlling member of LLC was personally liable for knowingly participating in LLC's fraud in relation to LLC's contract and fraudulent transfers of LLC assets based on the principle that a corporate officer who knowingly participates in tortious or fraudulent acts may be held individually liable to third persons even though the officer was acting as an agent of the corporation); *see also In re Arnette,* 454 B.R. 663 (Bankr. N.D. Tex. 2011); *In re Williams,* 2011 WL 240466 (Bankr. W.D. Tex. Jan. 24, 2011); *Sanchez v. Mulvaney*, 274 S.W.3d 708, 712 (Tex.App.–San Antonio 2008, no pet.); *LJ Charter, L.L.C. v. Air America Jet Charter, Inc.*, 2009 WL 4794242 (Tex.App.–Houston [14th Dist.] Dec. 15, 2009, pet. denied). In *Watkins v. Basurto*, 2011 WL 1414135 (Tex. App.–Houston [14th Dist.] 2011, no pet.), the court noted that Texas law is unsettled as to whether an agent of a corporation or LLC can be held individually liable for the tort of negligent hiring or supervision, i.e., whether an agent owes a duty to third parties to properly hire or supervise other agents of the principal.

### B. Liability on LLC's Contract as Agent of Partially Disclosed Principal or as Guarantor

An agent is not liable on a contract entered into on the principal's behalf if the agent discloses the agent's representative capacity and the identity of the principal. Conversely, if the representative capacity of the agent and the identity of the agent's principal are not disclosed to the other party to the contract at the time the contract is entered into, the agent is personally liable on the contract. Restatement (Third) of Agency §§ 6.01, 6.02 (2006); Restatement (Second) of Agency §§ 320, 322 (1957). There are numerous Texas cases applying these principles in the context of contracts entered into by corporate agents. The common corporate practice of doing business under assumed or trade names creates some peril for officers and other agents who contract under the assumed or trade name of the corporation without disclosing the actual legal name of the corporation. *See, e.g., John C. Flood of DC, Inc. v. SuperMedia, L.L.C.*, 408 S.W.3d 645 (Tex.App.–Dallas 2013, pet. denied); *Lake v. Premier Transp.*, 246 S.W.3d 167 (Tex.App.– Tyler 2007, no pet.); *Wynne v. Adcock Pipe and Supply*, 761 S.W.2d 67 (Tex.App.–San Antonio 1988, no writ); *A To Z Rental Center v. Burris,* 714 S.W.2d 433 (Tex.App.–Austin 1986, writ ref'd n.r.e.). The filing of an assumed name certificate that discloses the legal name of the corporation does not in itself protect agents who contract in the assumed name of the corporation because Texas courts have stated that actual knowledge or reason to know the principal's identity is the test of disclosure and that third parties have no duty to search for this information. *Wynne v. Adcock Pipe and Supply*, 761 S.W.2d 67 (Tex.App.–San Antonio 1988, no writ); *A To Z Rental Center v. Burris,* 714 S.W.2d 433 (Tex.App.–Austin 1986, writ ref'd n.r.e.). These basic agency principles have application in the LLC as well as the corporate context. *See, e.g., Water, Waste & Land, Inc. v. Lanham*, 955 P.2d 997 (Colo. 1998) (holding member-managers of LLC personally liable under common law of agency with respect to contract entered into on behalf of LLC where LLC was partially disclosed principal).

Even if an agent discloses the identity of the principal and signs a contract indicating the agent's representative capacity, the language of the contract may subject the agent to liability as a guarantor or party to the contract. *See 84 Lumber Co., L.P. v. Powers*, 393 S.W.3d 299 (Tex.App.–Houston [1st Dist.] 2012, pet. denied) (holding individual who signed credit application as president of corporation liable as personal guarantor of the corporation's debt based on language above the signature line stating that the signatory personally guaranteed the credit account of the corporation); *Wholesale Builders Supply, Inc. v. Green-Source Dev., L.L.C.*, No. 9971, 2013 WL 6175210 (Ohio App. Nov. 21, 2013) (holding individual who signed LLC credit application personally liable based on language in the credit application stating that the signatory was "both personally and corporately liable for the total of purchases by you or anyone designated to sign for your purchases on your account"). Corporate and LLC representatives should be vigilant when signing credit applications and other contracts on behalf of the corporation or LLC in order to avoid subjecting themselves to personal liability under provisions that may be interpreted to obligate signatories in their individual capacities.

### C. Liability of Members for Wrongful Distributions

The BOC prohibits a distribution by an LLC to its members if the distribution would leave the LLC insolvent using a balance sheet test. The statute provides that an LLC may not make a distribution to a member if, immediately after the distribution, the company's total liabilities (excluding liabilities to members for unpaid distributions) would exceed the company's total assets. Tex. Bus. Orgs. Code § 101.206(a), (b)(1). If the LLC has any liability for which recourse is limited to specific assets of the LLC, the liability is excluded from the calculation. Tex. Bus. Orgs. Code § 101.206(b)(2). Likewise, the calculation includes the fair value of an asset subject to a liability for which recourse of the creditor is limited only to the extent that the fair value of the asset exceeds the liability. Tex. Bus. Orgs. Code § 101.206(c).

In 2009, the BOC was amended to clarify that the limitation on distributions to LLC members does not include payments to members for reasonable compensation or reasonable payments in the ordinary course of business pursuant to a bona fide retirement plan or other benefits program. Tex. Bus. Orgs. Code § 101.206(f). In addition, the statute was amended to make clear that a distribution that is in compliance with Chapter 11 of the BOC does not violate the limitation on distributions. Tex. Bus. Orgs. Code § 101.206(a). In other words, an LLC that is winding up might technically be insolvent as a result of a distribution but would not violate the limitation on distributions if "adequate provision" has been made for the payment of the remaining liabilities, such as by the assumption of the liabilities by a purchaser of the LLC's assets. *See* Tex. Bus. Orgs. Code § 11.053(a).

The BOC provides that a member who impermissibly receives a distribution has no obligation to return it to the LLC unless the member knew that it violated the statutory restriction. Tex. Bus. Orgs. Code § 101.206(d). The statute does not expressly grant creditors the right to enforce the return of a distribution to the LLC, but a court might recognize a creditor's standing to bring a derivative action to do so. The statute does not affect any obligation a member may have to return a distribution under "other state or federal law." Tex. Bus. Orgs. Code § 101.206(e). Thus, the United States Bankruptcy Code (11 U.S.C. §§ 101 et seq.) and Texas Uniform Fraudulent Transfer Act (Tex. Bus. & Com. Code §§ 24.001 et seq.) present creditors with other means to pursue recovery. *See In re Brentwood Lexford Partners, LLC*, 202 B.R. 255 (Bankr. N.D.Tex. 2003) (holding certain excess cash-flow distributions to LLC members were fraudulent transfers because they were made with intent to hinder or delay collection of a note owed by the LLC). Knowledge or intent is not always required under these other fraudulent transfer provisions. *See* Tex. Bus. & Com. Code § 24.006(a).

The limitation on distributions under the BOC is primarily for the protection of creditors but also protects members from the undue depletion of LLC assets. Additionally, the company agreement may impose stricter requirements on members to return distributions. The statute expressly provides that it does not affect any obligation of the members under the company agreement to return a distribution. Tex. Bus. Orgs. Code § 101.206(e). Release of a member's obligation to return an impermissible distribution requires consent of all members unless otherwise provided by the company agreement. Tex. Bus. Orgs. Code § 101.154. A creditor who acts in reliance on an enforceable obligation to return a distribution may enforce the obligation even though it has been settled or released if the obligation is stated in a document that is signed by the member and the document has not been amended or canceled to evidence the release or settlement. Tex. Bus. Orgs. Code § 101.155.

### D. Liability of "Directors and Officers" for Debts Incurred After Tax Forfeiture of LLC

Chapter 171 of the Texas Tax Code sets forth procedures for administrative forfeiture of the privileges of a corporation when the corporation fails to pay its franchise tax or file required reports. Forfeiture of a Texas corporation's privileges is followed by forfeiture of the corporation's charter (i.e., its certificate of formation) if the corporation's default is not cured. Among the effects of forfeiture of a corporation's privileges is personal liability of directors and officers for certain corporate obligations. Under the Tax Code, "[i]f the corporate privileges of a corporation are forfeited for the failure to file a report or pay a tax or penalty, each director or officer of the corporation is liable for each debt of the corporation that is created or incurred in this state after the date on which the report, tax, or penalty is due and before the corporate privileges are revived." Tex. Tax Code § 171.255(a). Although these provisions are expressed in corporate terms, they also apply to other taxable entities, such as limited partnerships and limited liability companies. Tex. Tax Code § 171.2515(b). The statute does not state who is a "director" or "officer" of an LLC for purposes of Section 171.255. The Public Information Report required by the Tax Code to be filed annually by a corporation or LLC requires the entity to list each officer and director of the entity. Tex. Tax Code 171.203. The instructions to the Public Information Report state that an LLC should list its managers, its members, if the LLC is member-managed, and its officers, if any. *See Bruce v. Freeman Decorating Servs., Inc.*, No. 14-10-00611-CV, 2011 WL 3585619 (Tex.App.–Houston [14th Dist.] Aug. 15, 2011, pet. denied) (rejecting argument that Section 171.255 only applies to corporations and holding individual who signed LLC's Public Information Reports in years preceding forfeiture, and who was listed as officer and/or director of LLC in such reports, could reasonably be inferred to be officer or director at time debt at issue was created or incurred and was personally liable for amounts owed for services provided to LLC after forfeiture).

A director or officer has an affirmative defense to liability with respect to any debt created or incurred over the director's objection or without the director's knowledge if the exercise of reasonable diligence to become acquainted with the affairs of the corporation would not have revealed the intention to create the debt. Tex. Tax Code § 171.255(c). Note that once a corporation's privileges are forfeited (the first step in a forfeiture of the corporation's charter), Section 171.255 provides that the personal liability of officers and directors extends back to debts created or incurred after the report, tax, or penalty was due and continues until the privileges are revived. Revival of a corporation's charter and corporate privileges does not affect the liability of a director or officer for debts incurred before the corporate privileges are revived. Tex. Tax Code § 171.255(d). The specific inclusion of liability for "any tax or penalty" imposed by Chapter 171 of the Tax Code after the forfeiture does not limit the scope of the debts for which directors and officers have personal liability under Section 171.255. The statute expressly provides that officers and directors are liable for "each debt" incurred under the specified circumstances, in addition to the liability for taxes and penalties. *See Bosch v. Cirro Group, Inc.*, No. 03-11-01625-CV, 2012 WL 5949481 (Tex.App.–Dallas Nov. 28, 2012, pet. denied).

In a number of cases, courts have wrestled with when a debt was incurred or created for purposes of Section 171.255 or its statutory predecessor. *See, e.g.*, *Schwab v. Schlumberger Well Surveying Corp.*, 154 Tex. 379, 198 S.W.2d 79 (1946) (holding debt was created or incurred when original promissory note was executed before forfeiture rather than when subsequent renewal notes were executed); *Cain v. State*, 882 S.W.2d 515 (Tex.App.–Austin 1994, no writ) (applying rule of strict construction and holding debt for amounts expended by State of Texas to plug wells was created or incurred when State expended funds, rather than date of prior authorization by State to expend funds to plug wells, because debt was unliquidated obligation prior to actual expenditure); *River Oaks Shopping Center v. Pagan*, 712 S.W.2d 190 (Tex.App.–Houston [14th Dist.] 1986, writ ref'd n.r.e.) (holding post-forfeiture breach and damages related back to execution of lease so that debt was created or incurred on date of execution of lease); *Rogers v. Adler*, 697 S.W.2d 674 (Tex.App.–Dallas 1985, writ ref'd n.r.e.) (holding debt was created when contract was entered into prior to forfeiture rather than when judgment was entered after forfeiture); *Curry Auto Leasing, Inc. v. Byrd*, 683 S.W.3d 109 (Tex.App.–Dallas 1984, no writ) (holding corporate debts arising from failure to adhere to leasing contract related back to, and were created or incurred, when rental agreement was entered into rather than at the time defaults occurred).

Several recent cases have examined the issue of when a debt was created or incurred for purposes of liability of officers and directors under Section 171.255. In a case involving an employment contract that required yearly payments, the court of appeals held that the debt was created when the contract was signed rather than when each payment became due. *Beesley v. Hydrocarbon Separation, Inc.*, 358 S.W.3d 415, 423 (Tex.App.–Dallas 2012, no pet.) (discussing other cases in which a debt was deemed to be created or incurred when the underlying contract was originally entered into rather than when a later breach, judgment, or renewal occurred). In *Taylor v. First Community Credit Union*, 316 S.W.3d 863 (Tex.App.–Houston [14th Dist.] 2010, no pet.), the court of appeals held an officer/director of a forfeited automobile dealership personally liable to a credit union for damages resulting from the corporation's breach of a dealership agreement on the basis that the debt was created or incurred when the agreement was breached, which occurred after the dealership's franchise tax report was due, rather than when the dealership entered into the contract in 2003, before the franchise tax was due. The court discussed a number of other cases dealing with the timing of when a debt is created or incurred for purposes of Section 171.255, and the court found earlier cases in which courts had based the creation or incurrence on the execution of the original contract were either distinguishable on their facts or impacted by a definition of "debt" adopted by the legislature in 1987. This definition stated that a "debt" is "any legally enforceable obligation measured in a certain amount of money which must be performed or paid within an ascertainable period of time or on demand." A holding that the execution of the dealer agreement in this case created a debt under Section 171.255 when no breach had occurred and no money was owed at that time would have conflicted with the statutory definition, and the court therefore declined to follow case law pre-dating the definition that would have equated the creation of the debt with entering into the contract. The definition relied upon by the court in *Taylor* was repealed in 2008 when the new margin tax provisions took effect, and there is currently no statutory definition of "debt" in Chapter 171 of the Tax Code. In *Endsley Electric, Inc. v. Altech, Inc.*, 378 S.W.3d 15 (Tex.App.–Texarkana 2012, no pet.), a contractor sued an electrical subcontractor and the subcontractor's officers for breach of contract, and the court of appeals held there was no evidence that the liability was created or incurred after the corporate forfeiture so as to hold the officers of the subcontractor liable under Section 171.255 of the Tax Code. The contract was signed in October 2008 and completed in March or April 2010. The suit was filed on April 14, 2010, the subcontractor's charter was forfeited by the Secretary of State under Section 171.309 of the Tax Code for failure to pay franchise taxes on January 28, 2011, and the judgment in the suit was entered in August 2011.

In *Tryco Enterprises, Inc. v. Robinson*, 390 S.W.3d 497 (Tex.App.–Houston [1st Dist.] 2012, pet. dism'd), concurring and dissenting justices expressed differing views on whether James and Sharon Dixon, the owners and officers of a forfeited corporation, had personal liability under Section 171.255 of the Tax Code with respect to amounts owed by the corporation on a judgment stemming from violations of the Fair Labor Standards Act. The corporation's charter was forfeited after the jury verdict and shortly before the judgment was entered. The majority found it unnecessary to reach the issue of the Dixons' liability under Section 171.255 because it concluded the record supported personal liability based on veil-piercing findings. The dissenting justice did not believe that the record supported personal liability on veil-piercing grounds and thus analyzed whether the Dixons had personal liability as officers under Section 171.255, i.e., whether the FLSA liability at issue was a debt "created or incurred in this state after the date on which the report, tax, or penalty is due and before the corporate privileges are revived." The dissenting justice concluded that the debt for unpaid overtime wages was created or incurred on the paydays for the pay periods in which the overtime labor was performed and that there was thus no liability for these amounts under Section 171.255 since the paydays preceded the event occasioning the forfeiture of corporate privileges. On the other hand, the dissent concluded that the Dixons did have personal liability under Section 171.255 for the statutory penalties and attorney's fees included in the judgment, reasoning that these amounts were not created or incurred until the trial court determined the amount of these awards in its judgment, which was entered after the forfeiture. In a lengthy analysis of the application of Section 171.255, the concurring justice concluded that the Dixons had personal liability for the entire amount of damages in the FLSA suit on the basis that the debt was not created until the judgment was entered after the corporation's forfeiture. The concurring justice reasoned that the damages were not the type of debt to which the relation-back doctrine applies and were not a sum certain (as required under the definition of "debt" in effect at the time) until the judgment in the FLSA lawsuit was entered.

Some courts have concluded that "debts" for which directors and officers may have personal liability under Section 171.255 do not include tort liability based on negligence. *Williams v. Adams*, 74 S.W.3d 437 (Tex.App.–Corpus Christi 2002, pet. denied); *Suntide Sandpit, Inc. v. H & H Sand and Gravel, Inc.*, No. 13-11-00323-0CV, 2012 WL 2929605 (Tex.App.–Corpus Christi July 19, 2012, pet. denied). In *Segarra v. Implemetrics, Inc.*, Civil Action No. 4:13-CV-217, 2013 WL 5936602 (S.D. Tex. Nov. 5, 2013), the court appeared to accept that the plaintiff's employment discrimination claims could give rise to a "debt" under Section 171.255(a) but concluded the debt would not be created or incurred until entry of a judgment.

## V. Series LLCs

In 2009, Subchapter M (consisting of Sections 101.601-101.621) was added to Chapter 101 of the BOC to permit an LLC's company agreement to establish "series" of members, managers, membership interests, or assets. These provisions in the BOC are similar to provisions in the Delaware LLC statute, and they essentially permit an LLC to be structured so that it has separate divisions, i.e., "series" of assets and liabilities, that can have different ownership, management, and activities from other series. If certain statutory requirements are met, the liabilities and obligations of a particular series are enforceable only against the assets of that series, and the liabilities or obligations of any other series are not enforceable against the assets of that series. For this limitation on liability to apply, (1) the LLC's certificate of formation must contain a notice of the limitation of liability with respect to the LLC's series, (2) the company agreement must contain a statement to the effect of the limitation on liability with respect to the series, and (3) the LLC's records maintained for a series must account for the assets associated with the series separately from the other assets of the LLC or any other series. The records requirement is met if records are maintained in a manner so that the assets of the series can be reasonably identified by specific listing, category, type, quantity, or computational or allocational formula or procedure, including a percentage or share of any assets, or by any other method under which the identity of the assets can be objectively determined. Tex. Bus. Orgs. Code § 101.603(b). An LLC need not yet have established any series when a notice regarding limitation of liability of series is included in the certificate of formation, and the notice need not make reference to a specific series; therefore, a general notice tracking the statutory language describing the limitation of liability of series may be included in an LLC's certificate of formation even though the LLC is not initially structured with series, and the LLC would then have the flexibility in the future to establish series without the necessity of any amendment to its certificate of formation. Tex. Bus. Orgs. Code § 101.604.

Although a series is not actually a separate entity from the LLC (*see* Tex. Bus. Orgs. Code § 101.622), a series has the power and capacity in its own name to (1) sue or be sued; (2) contract; (3) acquire, sell, and hold title to assets; (4) grant liens in its assets; and (5) exercise any power or privilege necessary or appropriate to the conduct, promotion, or attainment of the business, purposes, or activities of the series. Tex. Bus. Orgs. Code § 101.605. Assets of a series may be held directly or indirectly in the name of the series, the LLC, through a nominee, or otherwise. Tex. Bus. Orgs. Code § 101.603. Under the Assumed Business or Professional Name Act, an LLC must filed an assumed name certificate if a series of the LLC conducts business under a name other than the name of the LLC as stated in the LLC's certificate of formation. See Tex. Bus. & Com. Code Ann. §§ 71.002(2)(H), 71.101. A member or manager associated with a series is protected from liability for the debts and obligations of the series in the same manner as a member or manager is protected generally from liability for the debts and obligations of the LLC. Tex. Bus. Orgs. Code § 101.606(a). The duties of a member, manager, officer, or other person associated with a series may be expanded or restricted in the company agreement. Tex. Bus. Orgs. Code § 101.606(b).

The governance provisions applicable to series are quite flexible. Notwithstanding any conflicting provision in the LLC's certificate of formation, the governing authority of a series consists of managers or members associated with the series as provided in the company agreement. Tex. Bus. Orgs. Code § 101.608(a). If the company agreement does not provide for the governing authority of the series, the company's certificate of formation determines whether the series is manager-managed or member-managed. Tex. Bus. Orgs. Code § 101.608(b). A company agreement may give special rights, powers, and duties to classes or groups of members or managers associated with a series, including voting rights. Tex. Bus. Orgs. Code § 101.607. An event that causes a manager or member to cease to be a manager or member with respect to any series does not, in and of itself, cause the manager or member to cease to be a manager or member of the LLC or another series or require the winding up of the series. Tex. Bus. Orgs. Code § 101.610. Subchapter M contains rules concerning distributions with respect to a series that are adapted from the general provisions on distributions of an LLC. Tex. Bus. Orgs. Code §§ 101.611-101.613.

Subchapter M contains provisions addressing the winding up and termination of a series, and certain provisions of Chapter 11 are incorporated by reference and made applicable in the series context. Tex. Bus. Orgs. Code §§ 101.614-101.621. To the extent not inconsistent with Subchapter M, the provisions of Chapter 101 apply to a series and its managers and members on a series by series basis. Tex. Bus. Orgs. Code § 101.609. In addition, subsection (c) of section 101.609 specifies that certain provisions of Title 1 apply to a series and its governing persons and officers. The provisions of Title 1 that apply to a series and its governing persons and officers encompass provisions that allow a governing person or officer to rely on certain types of information in discharging a duty or exercising a power, provisions addressing the maintenance of books and records and a governing person's right of access to books and records, and provisions regarding transfer and disposition of property. Tex. Bus. Orgs. Code § 101.609(c).

The series concept should not be utilized without considering the risks and uncertainties associated with the use of series. Most state LLC statutes do not contain provisions addressing series. Thus, there is a question as to whether these other states would recognize the internal liability shield associated with a series. *See Alphonse v. Arch Bay Holdings, L.L.C.*, __ Fed. App'x __, 2013 WL 6490229 (5th Cir. 2013) (discussing the question of whether a series of a Delaware LLC is a separate juridical entity and taking issue with the district court's conclusion that Delaware law applied under the applicable Louisiana conflict-of-laws provision, which states that "[t]he laws of the state or other jurisdiction under which a foreign limited liability company is organized shall govern its organization, its internal affairs, and the liability of its managers and members that arise solely out of their positions as managers and members;" noting distinction between internal and external affairs and remanding for district court to consider whether the liability of an LLC or its series to third parties is internal or external). Other unsettled questions relating to series include the federal income tax treatment of a series (proposed regulations were issued by the IRS in September of 2010) and how a series would be treated under bankruptcy law (e.g., whether the internal liability shield would be effective in a bankruptcy context). The Texas Comptroller has determined that a series LLC is a single taxable entity that must file one franchise tax report as a single entity, not as a combined group. If one series of a foreign LLC has nexus in Texas, the entire series LLC has nexus in Texas.

## VI. Fiduciary Duties in LLCs

### A. Fiduciary Duties of Managers and Members

The provisions of the Texas Business Organizations Code ("BOC") governing LLCs (like the provisions of the predecessor Texas Limited Liability Company Act ("TLLCA")) do not define or expressly impose fiduciary duties on managers or members of an LLC, but various provisions of the statute implicitly recognize that such duties may exist. Indeed, when acting as an agent of the LLC, a manager or managing member owes a duty of care pursuant to basic agency principles. RESTATEMENT (THIRD) OF AGENCY § 8.08; *see also* RESTATEMENT (SECOND) OF AGENCY § 379. Further, the agent status of a manager in a manager-managed LLC and a member in a member-managed LLC provides a basis under agency law to impose a duty of loyalty. *See* RESTATEMENT (THIRD) OF AGENCY §§ 8.01-8.06; *see also* Restatement (Second) of Agency §§ 387-398. In *Johnson v. Brewer & Pritchard, P.C.*, 73 S.W.3d 193 (Tex. 2002), the Texas Supreme Court discussed the fiduciary nature of the agency relationship under Texas common law. Cases are beginning to recognize agency law as well as analogies to corporate or partnership law as a basis to impose fiduciary duties in the LLC context. *See In re Hardee*, 2013 WL 1084494 (Bankr. E.D. Tex. 2013) (concluding managing member owed LLC formal fiduciary duties based on agency law; managing member owed formal fiduciary duties to LLC based on implication of Texas LLC law that managers and managing members owe fiduciary duties of care, loyalty, and obedience similar to corporate directors; managing member owed no fiduciary duties to other members); *In re TSC Sieber Servs., LC*, 2012 WL 5046820 (Bankr. E.D. Tex. 2012) (finding individual who took over managerial control of LLC but had no formal office or ownership interest owed LLC a formal fiduciary duty based on agency law and an informal fiduciary duty based on circumstances giving rise to control).

Commentators and practitioners have generally assumed that managers in a manager-managed LLC and members in a member-managed LLC have fiduciary duties along the lines of corporate directors or general partners in a partnership. These duties would generally embrace a duty of obedience, duty of loyalty, and duty of care to the LLC. Duty of loyalty concerns underlie statutory provisions addressing interested manager transactions and renunciation of business opportunities. *See* Tex. Bus. Orgs. Code §§ 2.101(21), 101.255; *see also* Tex. Rev. Civ. Stat. art. 1528n, art. 2.17 (expired eff. Jan. 1, 2010); Tex. Bus. Corp. Act art. 2.02(20) (expired eff. Jan. 1,

2010) (applicable by virtue of Tex. Rev. Civ. Stat. art. 1528n, art. 2.02A (expired eff. Jan. 1, 2010)). Provisions of the BOC permitting governing persons (including managers and managing members of an LLC) to rely on various types of information in discharging a duty implicitly recognize that such persons are charged with a duty of care in their decision making. Tex. Bus. Orgs. Code § 3.102; *see also* Tex. Bus. Orgs. Code § 3.105 (reliance by officers on information in discharging a duty). Finally, as further discussed below, the BOC provides that, to the extent managers or members are subject to duties and liabilities, including fiduciary duties, the company agreement may expand or restrict the duties and liabilities and provide for indemnification. Tex. Bus. Orgs. Code §§ 101.401, 101.402, 101.052; *see also* Tex. Rev. Civ. Stat. art.1528n, art. 2.20 (expired eff. Jan. 1, 2010).

Most of the Texas cases in which fiduciary duties have been an issue involve claims by a member against a fellow member for breach of fiduciary duty rather than claims based on a breach of fiduciary duty to the LLC. *Allen v. Devon Energy Holdings, L.L.C.* 367 S.W.3d 355 (Tex. App.—Houston [1st Dist.] 2012, pet. granted, judgm't vacated w.r.m.) contains the most extensive analysis to date of the question of whether members of a Texas LLC are in a formal fiduciary relationship *vis a vis* one another. Before *Allen*, a number of other courts in Texas had encountered breach of fiduciary duty claims asserted by an LLC member against a fellow member, but the discussion of those claims tended to be relatively cursory or uninformative. In *Allen*, a minority member of an LLC, sued the LLC and its majority member and sole manager, alleging that the majority member/manager misrepresented and failed to disclose material facts in connection with the redemption of the minority member's interest in the LLC. The court declined to recognize a broad formal fiduciary duty on the part of a majority member to a minority member because Texas does not recognize such a relationship between majority and minority shareholders in closely held corporations, but the court concluded that the majority member's position as the controlling member and sole manager was sufficient to create a formal fiduciary duty to the minority member in a transaction in which the minority member's interest was being redeemed (thus increasing the ownership of the majority member). The court did not address the scope of the duty. The court also concluded that an exculpation provision in the articles of organization referring to the manager's "duty of loyalty to [the LLC] or its members" could be read to create a fiduciary duty to the members individually. With regard to the oppression claim, the court relied upon Texas case law defining "shareholder oppression" and concluded that the trial court properly granted the defendants' motion for summary judgment on the minority member's oppression claim. The court stated that the allegations of "wrongful conduct" of fraud and breach of fiduciary duty in connection with the redemption of the minority member's interest were not similar to previously recognized examples of shareholder oppression in the case law (listing termination of employment, denial of access to books and records, wrongful withholding of dividends, waste of corporate funds, excessive compensation, lock-out from corporate offices, and squeeze-out as examples of "typical wrongdoing in shareholder oppression cases") and that the minority member cited no case allowing fraud or breach of fiduciary duty to be the basis of a shareholder oppression claim. The court stated in a footnote that it was expressing no opinion as to whether the shareholder oppression doctrine applies in the LLC context.

In an unpublished opinion, the Dallas Court of Appeals concluded that members of an LLC do not necessarily owe other members fiduciary duties. *Suntech Processing Systems, L.L.C. v. Sun Communications, Inc.,* 2000 WL 1780236 (Tex. App.—Dallas Dec. 5, 2000, pet. denied). The court relied on Texas case law rejecting the notion that co-shareholders of a closely held corporation are necessarily in a fiduciary relationship. That the articles of organization imposed upon members a duty of loyalty to the LLC did not mandate any such duty between the members according to the court.

In *Pinnacle Data Services, Inc. v. Gillen*, 104 S.W.3d 188 (Tex.App.–Texarkana 2003, no pet.), a member of an LLC sued the other two members alleging various causes of action based on the action of the other two members in amending the LLC articles of organization to change the LLC from a member-managed LLC to a manager-managed LLC and excluding the plaintiff member from management. The plaintiff member owned a 50% interest in the LLC. The regulations required the approval of 66 2/3% in interest to amend the articles of organization, while the articles of organization required the approval of 2/3 of the members. The defendant members relied on the provision in the articles of organization, and the court held that the provision in the articles controlled because the TLLCA permits the regulations to contain any provision not inconsistent with the articles of organization. The court of appeals reversed the trial court's summary judgment in favor of the defendant members on the breach of fiduciary duty claim, however, stating that the determination that the articles of organization controlled disposed of the breach of contract claim, but not the breach of fiduciary duty-based claims. The court seemed to suggest that the duties of the defendants might be comparable to those of corporate directors and officers, but the court was not clear as to whether the presence of factors supporting an informal fiduciary relationship might be required. The court apparently accepted that an LLC member may bring a claim for "oppression" as defined in the corporate context, but the court upheld summary judgment in favor of the defendants on this claim, stating that the plaintiff had failed to set forth any evidence in support of its oppression claim.

In *Doonan v. Wood*, 224 S.W.3d 271 (Tex.App.–El Paso 2005, no pet.), the court rejected the breach of fiduciary duty claim of an LLC's minority member and his spouse against an investment company limited partnership that made a loan to the LLC and acquired a membership interest. The court stated that the minority member's spouse did not establish that she was owed a fiduciary duty, and, assuming a fiduciary duty was owed to the minority member, the various acts alleged, including foreclosure on LLC assets and enforcement of the minority member's personal guaranty, did not raise any genuine issue of material fact as to breach of fiduciary duty because the actions were taken for legitimate business reasons rather than for the fiduciary to profit by taking advantage of its position.

In *Lundy v. Masson*, 260 S.W.3d 482 (Tex.App.–Houston [14th Dist.] 2008, pet. denied), a corporation asserted breach of fiduciary duty claims against its former president. In the course of the opinion, the court revealed that the corporation was originally formed as an LLC and later converted to a corporation. The jury was instructed that the president owed the company a fiduciary duty, and the jury found that he breached his duty. The trial court entered a judgment for the corporation. On appeal by the former president, the court of appeals found that the evidence was sufficient to establish a breach of fiduciary duty and affirmed.

In *Gadin v. Societe Captrade*, 2009 WL 1704049 (S.D. Tex. 2009), the plaintiff, a 35% member of an LLC, sued the 65% member for breach of fiduciary duty, minority member oppression, and an accounting. The plaintiff alleged that there was an attempt to purchase his membership interest at an under-valued price, that he was forced to resign from the LLC, and that the defendant and its principals took clients, records, and financial information from the LLC. The defendant sought dismissal of the breach of fiduciary duty claim on the basis that the plaintiff failed to state facts showing that a member of an LLC owes another member a fiduciary duty or that there was more than a subjective trust by the plaintiff in the defendant so as to support an informal fiduciary relationship. The plaintiff responded that he used his personal credit, business contacts, and name in order to fund the start-up and business operations of the LLC and that he relied upon the representations by the defendant and its principals that his investment of time and resources would make his stake in the LLC profitable. The court discussed formal and informal fiduciary relationships under Texas law and noted that the TLLCA does not directly address the duties owed by managers and members. The court stated that Texas courts have not yet held that a fiduciary duty exists as a matter of law among members in an LLC and noted that, where fiduciary duties among members have been recognized in other jurisdictions, the duties have been based on state-specific statutes. The court denied the defendant's motion to dismiss "[b]ecause the existence of a fiduciary duty is a fact-specific inquiry that takes into account the contract governing the relationship as well as the particularities of the relationships between the parties." The court noted that the defendant's motion to dismiss did not address the plaintiff's claim for minority member oppression.

In *Entertainment Merchandising Technology, L.L.C. v. Houchin*, 720 F.Supp.2d 792 (N.D. Tex. 2010), the court, in responding to a claim that an individual owed a fiduciary duty by virtue of his status as officer of the LLC, stated that no Texas court has held that fiduciary duties exist between LLC members as a matter of law, and the court concluded that the statute of limitations barred the breach of fiduciary duty claim in any event.

In *In re Jones (Mullen v. Jones)*, 2011 WL 479063 (Bankr. N.D. Tex. Feb. 3, 2011), the court discussed at length the current state of Texas partnership law with respect to fiduciary duties of general partners. In the course of that discussion, the court noted that shareholders of a corporation do not generally owe other shareholders fiduciary duties and further noted that the law also seems to be developing toward the notion that members of a limited liability company do not necessarily owe other members fiduciary duties.

In *Federal Insurance Company v. Rodman*, 2011 WL 5921529 (N.D. Tex. Nov. 29, 2011), the court stated that there is no formal fiduciary relationship created as a matter of law between members of an LLC, but the court recognized that an informal fiduciary relationship may arise under particular circumstances where there is a close, personal relationship of trust and confidence and concluded that an LLC member had sufficiently pled the existence of an informal fiduciary relationship with his fellow member based on an alleged long-standing friendship.

In *Cardwell v. Gurley*, No. 4-10-CV-706, 2011 WL 6338813 (E.D. Tex. Dec. 19, 2011), the court recited findings and conclusions of a Texas district court in previous litigation in which the district court concluded that the managing member of an LLC owed the other member direct fiduciary duties of loyalty, care, and disclosure, as well as owing duties to the LLC. The federal district court in this case held that the bankruptcy court did not err in giving preclusive effect to the state court's findings and conclusions and further held that the fiduciary duty owed by a managing member to his fellow LLC member was similar to the trust-type obligation owed by partners and corporate officers and thus sufficient to support an exception to discharge under Section 523(a)(4) of the Bankruptcy Code.

In *Haut v. Green Café Management, Inc.*, 2012 WL 2109260 (Tex. App.–Houston [14th Dist.] June 12, 2012, no pet.), Haut, a minority owner of a corporation and an LLC, was found liable for breach of fiduciary duty to the companies, and he argued on appeal that he owed no formal or informal fiduciary duty to the companies as a matter of law. The only argument Haut made regarding an informal fiduciary duty was that there was no trial evidence that he had a special relationship of trust and confidence prior to and apart from the agreement made the basis of the suit. Because Haut designated only a partial record for appeal, the court of appeals said that it must presume the omitted evidence was relevant and supported the trial court's judgment on the jury's findings. Furthermore, the court stated that Haut's argument lacked merit even if the partial record did not require the court to presume that the evidence supported the jury's finding because Haut did not timely object to the trial court's failure to include in the charge an instruction that a pre-existing relationship of trust and confidence was necessary to find a fiduciary relationship. The court also rejected Haut's argument that the evidence did not support a finding that Haut breached his fiduciary duty.

In *In re TSC Sieber Services, LC*, 2012 WL 5046820 (Bankr. E.D. Tex. Oct. 18, 2012), the bankruptcy court found that the defendant breached a fiduciary duty to the debtor LLC. The LLC was a family-owned LLC in which the defendant was not formally issued a membership interest or given an office to avoid entangling the family business with unrelated legal problems of the defendant and to protect the family from any negative ramifications that might arise from any known association with the defendant. When the defendant's sister was injured and could no longer provide day-to-day supervision of the business, the plan to conceal any involvement of the defendant was altered, and the defendant's father (who served as chairman of the LLC) and sister requested that the defendant take direct managerial control of the business. The defendant had no written employment or consulting agreement but received authorized compensation for his management services. Eventually, the defendant was terminated by his sister after an internal audit revealed he had misappropriated a significant amount of funds from the LLC in her absence. The court found that the defendant owed a formal fiduciary duty to the LLC because he was an agent of the LLC. In addition, the court found that the circumstances giving rise to the managerial control gave rise to an informal fiduciary duty pursuant to which the defendant was required to place the interest of the LLC above his own. Based on the defendant's repeated breaches of fiduciary duty, the trustee was entitled to actual damages and a constructive trust over a residence obtained by the defendant with funds he unlawfully diverted from the LLC.

In *Vejara v. Levior International, LLC*, 2012 WL 5354681 (Tex. App.– San Antonio Oct. 31, 2012, pet. denied) (mem. op.), Vejara, appearing pro se on appeal, alleged that the jury erred in finding that she breached a fiduciary duty to her fellow member in an LLC and that the trial court abused its discretion by not reversing the jury's decision on Levior's breach of fiduciary duty claim. Vejara argued that she owed no fiduciary duty to Levior because she was only a minority "shareholder" of the LLC. (The court referred to the owners or members of an LLC as "shareholders" throughout its opinion.) The first part of the jury question presupposed the existence of a fiduciary relationship between Vejara and Levior, and Vejara failed to object to the charge or request additional instructions. The appellate court held that Vejara waived her right to raise this complaint on appeal but went on to hold that the record showed the existence of a fiduciary duty on Vejara's part even if Vejara did not waive her right to complain about the existence of a fiduciary duty. The appellate court agreed that Vejara, as a minority shareholder of the LLC, did not owe a formal fiduciary duty to Levior as a matter of law since Texas does not recognize a broad formal fiduciary relationship between majority and minority shareholders in closely held companies. However, the court pointed out that Texas courts have recognized that the nature of the relationship between shareholders of an LLC may give rise to an informal fiduciary duty between the shareholders. Here, although not a majority shareholder, Vejara exhibited control and had intimate knowledge of the LLC's business affairs. Vejara created the company, entered leases on behalf of the company, held keys to the company's vans, and had exclusive access to the company's inventory held in storage. The appellate court concluded that Vejara's control and intimate knowledge of the LLC's affairs and plans gave rise to the existence of an informal fiduciary duty to Levior. The court of appeals concluded there was sufficient evidence to support the jury finding that Vejara breached her fiduciary duty to Levior and that the breach caused Levior injury.

In *In re Hardee (ETRG Investments, LLC v. Hardee)*, 2013 WL 1084494 (Bankr. E.D. Tex. Mar. 14, 2013), an LLC and two of its members sought a determination that debts to them arising from activities of the debtor, Hardee, while he was managing member of the LLC were nondischargeable in Hardee's bankruptcy. The plaintiffs alleged that Hardee's debts to them were nondischargeable on the basis that the debts were obtained by actual fraud or false representations or as debts arising from a defalcation by a fiduciary and/or embezzlement. After the trial, the court concluded that a debt to the LLC representing over $250,000 in embezzled funds was nondischargeable as a debt arising from a defalcation by a fiduciary and embezzlement, and a debt to the LLC of approximately $248,000 arising from Hardee's failure to tender employment taxes owed to the IRS was nondischargeable as a debt arising from a defalcation by a fiduciary. The court concluded, however, that the two members who sought an exception to Hardee's discharge failed to establish that Hardee was in a formal or informal fiduciary relationship with them as would be required to render the debt to them for the unpaid tax liabilities nondischargeable as arising out of a defalcation by a fiduciary. The court's opinion consists of findings of fact and conclusions of law after the trial in the adversary proceeding. The court determined that Hardee embezzled significant sums of money from the LLC and that his breaches of fiduciary duty included entering into an unauthorized lending relationship, not properly managing the LLC's affairs by diverting funds, and not tendering required tax payments to the IRS on behalf of the LLC. The failure to tender the required tax payments also clearly breached the regulations (i.e., company agreement) of the LLC.

The court found that Hardee, as the sole person authorized to transact business and direct the financial activities of the LLC, including the payment of tax obligations, acted as an agent of the LLC and as such had a formal fiduciary relationship. The failure to tender the tax payments was a willful breach of duty and thus a defalcation while acting in a fiduciary capacity. As for Hardee's relationship to the other plaintiffs, Tomlin and Scott, the court found that these members failed to establish that Hardee had a formal fiduciary relationship with them. The company agreement governing the LLC did not impose or even address any fiduciary duties owed by and among the LLC members. Furthermore, the court found that Tomlin and Scott failed to establish that Hardee had an informal fiduciary relationship with them or a trust relationship that existed prior to the creation of the tax obligations at issue that would create fiduciary duties to the members.In its conclusions of law, the court addressed the nondischargeability of debts arising from breach of fiduciary duties. The court addressed the concept of a fiduciary under federal bankruptcy law and the requirement that the relationship amount to a "technical" or "express" trust. The court then proceeded to set forth numerous conclusions of law regarding fiduciary duties as they related to this proceeding. The Texas Business Organizations Code, which governs LLCs, does not directly address or define the duties owed by managers and members but implies that certain duties may be owed and allows the contracting parties to specify the breadth of those duties in the LLC agreement. One type of fiduciary relationship recognized under Texas law is a formal fiduciary relationship that arises as a matter of law and includes relationships between principal and agent. An agent has authority to transact business or manage some affair for another person or entity and owes a duty of care. Texas law also recognizes that a fiduciary relationship exists between corporate officers or directors and the corporation they serve, and one of the duties imposed on corporate management is a duty of care that requires diligence and prudence in the management of the corporation's affairs. Although LLCs are not corporations in the strictest sense, Texas law implies that the fiduciary status of corporate officers and directors and their corresponding duties of care, loyalty, and obedience apply to managers and/or members governing the activities of an LLC. Thus, imposition of fiduciary duties on the management of an LLC under Texas law is appropriate and warranted, and Hardee acted in a fiduciary capacity as to the LLC. Hardee was charged with insuring that all required payments of employment taxes were made by the LLC to the appropriate taxing authorities, and Hardee's failure in each instance to make the tax payments on behalf of the LLC constituted a breach of the fiduciary duties he owed the LLC. Therefore, the debt owed by the LLC to the IRS to satisfy its tax obligations for the period in which the defendant was the managing member of the LLC constituted a defalcation by a fiduciary and was excepted from discharge in Hardee's bankruptcy proceeding. As for the individual members' request that any amount they were required to pay to satisfy the accrued IRS tax liabilities should also be a nondischargeable debt, the court noted a significant difference between a manager's fiduciary relationship to the LLC and the manager's relationship to fellow members. Case law has recognized that there is no formal fiduciary relationship created as a matter of law between members of an LLC. Thus, Hardee had no formal fiduciary relationship with either Tomlin or Scott. An informal fiduciary relationship is a confidential relationship arising from moral, social, domestic, or personal relationships in which one person trusts in and relies on another. The effect of imposing a fiduciary duty is to require the fiduciary party to place another's interest above its own, and a fiduciary relationship is thus not one that is created lightly. Hardee had no informal fiduciary relationship with either Tomlin or Scott. Any liability of Hardee to either Tomlin or Scott created by Hardee's failure to render tax payments on behalf of the LLC was not excepted from discharge as a result of a breach of fiduciary duties because the debtor owed no fiduciary duties to the members.

In *Kohannim v. Katoli*, __ S.W.3d __, 2013 WL 3943078 (Tex.App.–El Paso 2013, pet. denied), the former spouse of a member who was awarded the member's 50% interest in a divorce was unable to recover for breach of fiduciary duty against the remaining 50% member because the trial court did not make the requested finding that the remaining 50% member owed the former spouse a fiduciary duty and breached that duty. The court of appeals discussed formal and informal fiduciary relationships and concluded that the trial court deliberately refrained from finding the existence and breach of a fiduciary duty to the former spouse who owned the other 50% interest. The trial court made a finding that the 50% member owed the LLC a fiduciary duty and that the member breached that duty. The former spouse also asserted an oppression claim, and the court of appeals affirmed the trial court's finding that the 50% member engaged in oppression based on the member's failure to make distributions to the former spouse where the LLC regulations provided for distributions of "available cash," more than $250,000 in undistributed profit had accumulated in the company's accounts, and the 50% member paid himself for management services that were not performed. The other 50% member argued that only a minority shareholder may assert an oppression claim, but the court of appeals stated that Section 11.404 of the BOC provides that an oppression action can be directed at the directors or "those in control" of the entity and cited *Ritchie v. Rupe* as rejecting the argument that shareholder oppression can only be brought by a minority shareholder.

In *In re Lau (Pacific Addax Co., Inc. v. Lau)*, 2013 WL 5935616 (Bankr. E.D. Tex. Nov. 4, 2013), the debtors, John and Deborah Lau, were in the real estate business, and the plaintiffs sought a determination that the Laus' debts for the plaintiffs' losses in real estate ventures managed by the Laus were nondischargeable on various grounds, including as debts arising from fraud or defalcation in a fiduciary capacity. The plaintiffs' claims related to their investments in two real estate ventures, one of which was organized as an LLC. John and Deborah Lau were the sole members of an LLC that owned and sought to develop a tract of land. The plaintiffs purchased interests in the LLC and became members. John Lau exercised complete control over the LLC as the sole managing member. As the managing member of the LLC, John Lau issued capital calls, which were promptly paid by the plaintiffs. When the capital calls were made, John Lau supplied false information to the plaintiffs regarding the LLC, and the capital infusions made by the plaintiffs were diverted by John Lau for his own business purposes and those of another entity owed by the Laus. The plaintiffs received no return on their investments in the LLC. The court concluded that John Lau breached his fiduciary duties to the LLC and its members. The court noted that Chapter 101 of the Texas Business Organizations Code, like the predecessor Texas Limited Liability Company Act, does not directly address the duties owed by LLC managers and members but provides that the company agreement of an LLC may expand or restrict duties, including fiduciary duties, and related liabilities that a member, manager, officer or other person has to the company or to a member or manager. The court stated that the statute thus implies that certain duties may be owed without defining them and allows the contracting parties to specify the breadth of those duties in the company agreement. The regulations of the LLC conferred on John Lau as the manager-member the power and authority to act on behalf of the company subject to limitations set forth in the regulations and "the faithful performance of the Managers' fiduciary obligations to the Company and the Members." Thus, the court concluded that John Lau stood in a fiduciary relationship to the plaintiffs as members of the LLC. The court stated that recognition of this fiduciary duty was consistent with the degree of control exercised by John Lau as the managing member. The court also concluded that John Lau's representations and acts in connection with the capital calls were acts of fraud and constituted defalcations. Because John Lau's debts to the plaintiffs arose from fraud and defalcation in a fiduciary capacity they were excepted from discharge. Additionally, the court concluded that Deborah Lau knowingly participated in her husband's breach of fiduciary duty and ratified the breach of duty by knowingly accepting the benefits derived from the breach. Thus, Deborah Lau's liability for these debts was excepted from discharge as well.

Bankruptcy courts in some cases have analyzed breach of fiduciary duty claims against LLC members who were also officers of the LLC in terms of the duties of corporate directors without indicating any recognition that an LLC is not actually a corporation. *See In re Supplement Spot, LLC*, 409 B.R. 187 (Bankr. S.D. Tex. 2009) (relying on corporate law for the proposition that corporate officers have fiduciary duties to creditors in analyzing fraudulent transfer of LLC funds to pay mortgage debts of LLC officer); *In re Brentwood Lexford Partners, L.L.C.*, 292 B.R. 255 (Bankr. N.D. Tex. 2003) (discussing and relying on duties owed by corporate officers to corporation and creditors in analyzing claims against LLC officers arising from distributions while LLC was insolvent and officers' resignation from LLC and formation of new LLC to which some business was transferred); *In re Mega Sys., L.L.C.*, 2007 WL 1643182 (Bankr. E.D. Tex. 2007) (citing corporate case law rejecting proposition that duties are owed to corporate creditors when debtor approaches zone of insolvency in addressing breach of fiduciary duty claim against LLC's president/majority owner).

For cases in other states that have addressed fiduciary duties of managers or members, see Elizabeth S. Miller, *More Than a Decade of LLP and LLC Case Law: A Cumulative Survey of Cases Dealing With Limited Liability Partnerships and Limited Liability Companies*, June 2007, and subsequent LLC case law updates available at http://www.baylor.edu/law.

### B. Statutory Authorization to Modify Duties and Liabilities of Members and Managers in Governing Documents

**Exculpation of Liability and Restriction of Duties.** Prior to 1997, Article 8.12 of the TLLCA followed the corporate approach to exculpation of directors by incorporating by reference Article 7.06 of the Texas Miscellaneous Corporation Laws Act (Tex. Rev. Civ. Stat. art. 1302-7.06 (expired eff. Jan. 1, 2010)). The original version of Article 8.12 of the TLLCA indicated that a manager's liability could be eliminated in the articles of organization to the extent permitted for a director under Article 1302-7.06. In 1997, amendments to the statute effected a significant departure from this approach. The reference to Article 1302-7.06 was eliminated from the TLLCA, and a new provision, Article 2.20B, was added as follows:

> To the extent that at law or in equity, a member, manager, officer, or other person has duties (including fiduciary duties) and liabilities relating thereto to a limited liability company or to another member or manager, such duties and liabilities may be expanded or restricted by provisions of the regulations.

This provision (which is included in the BOC at Section 101.401) was modeled after similar provisions in the Delaware LLC and limited partnership acts[3] and leaves the extent to which duties and liabilities may be limited or eliminated to be determined by the courts as a matter of public policy. There is scant case law addressing this statutory power to limit duties and liabilities in Texas LLCs. The only case to discuss the contractual freedom of members in this regard is *Allen v. Devon Energy Holdings, L.L.C.* 367 S.W.3d 355 (Tex. App.—Houston [1st Dist.] 2012, pet. granted, judgm't vacated w.r.m.). In that case, the court noted that LLCs are expressly excluded from the statutory restriction on the limitation or elimination of liability of governing persons in Section 7.001 of the BOC, and the court stated that the members of an LLC are "free to expand or eliminate, as between themselves, any and all potential liability of" a manager of the LLC as the members see fit. The court also concluded that an exculpation provision in the articles of organization that largely tracked Section 7.001 of the BOC and referred to the manager's "duty of loyalty to [the LLC] or its members" could be read to create a fiduciary duty to the members individually. Section 7.001(d) of the BOC was amended in 2013 to clarify that the company agreement may eliminate the liability of a manager or managing member to the LLC and the other members to the same extent that a corporation's certificate of formation may eliminate a director's liability under Section 7.001 and to such further extent allowed by Section 101.401. There are no express prohibitions or limitations in Section 101.401 with respect to the limitation or elimination of liability of a manager or managing member to the LLC or the members. It should be noted that a distinction can be drawn between the limitation or elimination of duties and the limitation and elimination of liabilities. If the liability of a governing person is contractually eliminated, but the duty still exists, a breach of the duty could give rise to equitable relief (such as injunctive relief or receivership) even though the person could not be held liable for damages. Redefining or eliminating duties, on the other hand, narrows or eliminates not only potential liability for damages by the party who would otherwise owe the duty, but determines whether there is a breach at all, thus affecting the availability of equitable relief as well.

In addition to permitting the expansion or restriction of fiduciary duties of members and managers in the company agreement (Tex. Bus. Orgs. Code § 101.401), an LLC also has the specific power to renounce company opportunities. Tex. Bus. Orgs. Code § 2.101(21); *see also* Tex. Rev.

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[3] The Delaware statutes were amended in 2004 to expressly permit the elimination of fiduciary duties (but not the implied covenant of good faith and fair dealing) in a limited partnership agreement or LLC agreement. *See* Delaware Limited Liability Company Act § 18-1101. These amendments were a response by the Delaware legislature to a Delaware Supreme Court opinion signaling that the prior Delaware provision did not authorize elimination of fiduciary duties. *See Gotham Partners, L.P. v. Hollywood Realty Partners, L.P.*, 817 A.2d 160 (Del. 2002) (noting, in response to Chancery Court opinions indicating that the Delaware limited partnership act permitted a limited partnership agreement to *eliminate* fiduciary duties, that the statute actually stated that fiduciary duties and liabilities could be *expanded* or *restricted*, but did not state that they could be *eliminated*).

Civ. Stat. art. 1528n, art. 2.02A (expired eff. Jan. 1, 2010) (pursuant to which Tex. Bus. Corp. Act art. 2.02(20) (expired eff. Jan. 1, 2010) applied to an LLC).

Thus far, courts in other jurisdictions have been inclined to give effect to contractual provisions limiting fiduciary duties and specifying permissible conduct of LLC managers and members. In the first LLC case addressing issues of this sort to a significant degree, the Ohio Court of Appeals interpreted and enforced a provision of an operating agreement limiting the scope of a member's duty not to compete with the LLC. *McConnell v. Hunt Sports Enters.*, 725 N.E.2d 1193 (Ohio App. 1999). In this case, the court stated that LLC members (of what was apparently a member-managed LLC) are in a fiduciary relationship that would generally prohibit competition with the business of the LLC. The court concluded, however, that members may contractually limit or define the scope of the fiduciary duties. Specifically, the court recognized the validity of a provision in the operating agreement of an Ohio LLC that provided as follows:

> Members May Compete. Members shall not in any way be prohibited from or restricted in engaging or owning an interest in any other business venture of any nature, including any venture which might be competitive with the business of the Company.

Under this provision, the court found that a member was clearly and unambiguously permitted to compete against the LLC to obtain a hockey franchise sought by the LLC. The court rejected an argument that the provision only allowed members to engage in other types of businesses. The court commented that action related to obtaining the franchise or "the method of competing" could constitute a breach of duty if it amounted to "dirty pool," but noted the trial court's finding that the competing members had not engaged in willful misconduct, misrepresentation, or concealment.

For cases in other states that have addressed contractual provisions addressing fiduciary duties of managers or members, see Elizabeth S. Miller, *More Than a Decade of LLP and LLC Case Law: A Cumulative Survey of Cases Dealing With Limited Liability Partnerships and Limited Liability Companies*, June 2007, and subsequent case law updates available at http://law.baylor.edu.

**Indemnification.** Prior to 1997, the TLLCA provided that an LLC was permitted to indemnify members, managers, and others to the same extent a corporation could indemnify directors and others under the TBCA and that an LLC must, to the extent indemnification was required under the TBCA, indemnify members, managers, and others to the same extent. Thus, applying these provisions in the LLC context, indemnification was mandated in some circumstances even if the articles of organization and regulations were silent regarding indemnification. On the other hand, there were certain standards and procedures that could not be varied in the articles of organization or regulations. Article 2.20A of the TLLCA was amended in 1997 to read as follows:

> Subject to such standards and restrictions, if any, as are set forth in its articles of organization or in its regulations, a limited liability company shall have the power to indemnify members and managers, officers, and other persons and purchase and maintain liability insurance for such persons.

Tex. Rev. Civ. Stat. art. 1528n, art. 2.20A (expired eff. Jan. 1, 2010). Sections 8.002, 101.052, and 101.402 of the BOC generally carry forward this approach. Thus, the current LLC indemnification provisions neither specify any circumstances under which indemnity would be required nor place any limits on the types of liabilities that may be indemnified. It will be left to the courts to determine the bounds equity or public policy will place on the obligation or power to indemnify. Thus, for example, if a company agreement states that a manager or member "shall be indemnified to the maximum extent permitted by law," it is not clear how far the indemnification obligation extends. Would the LLC be required to indemnify for bad faith acts or intentional wrongdoing?

## VI. Member Oppression (i.e., Shareholder Oppression in LLC Context)

### A. History and Development of Oppression Action

Since 1955, "oppressive" conduct by the directors or those in control of a corporation has been grounds for a shareholder to obtain a receivership to rehabilitate the corporation. Tex. Bus. Corp. Act art. 7.05.A(1)(c) (expired); Tex. Bus. Orgs. Code § 11.404(a)(1)(C). (An unsuccessful rehabilitative receivership can lead to a liquidating receivership; therefore, although "oppression" is not directly grounds for court-ordered liquidation, "oppression" can indirectly lead to a liquidating receivership. Tex. Bus. Corp. Act art. 7.06.A(3) (expired); Tex. Bus. Orgs. Code § 11.405(a)(3).) When the Texas Limited Liability Company Act was enacted in 1991, it incorporated by reference the receivership provisions of the Texas Business Corporation Act ("TBCA"). Tex. Rev. Civ. Stat. art. 1528n, art. 8.12.A (expired). Section 11.404 of the Texas Business Organizations Code ("BOC") applies to partnerships (both general and limited) as well as corporations and limited liability companies ("LLCs"). (Interestingly, Section 11.404 of the BOC dropped the reference to "those in control" and simply refers to "governing persons." The "governing persons" of an entity include the board of directors of a corporation, the managers of a manager-managed LLC or members of a member-managed LLC, and general partners of a partnership; however, an owner of an entity (even a majority owner) would not fall within the definition of "governing person" if the owner is not also a member of the governing authority of the entity. *See* Tex. Bus. Orgs. Code § 1.002(35), (37).)

"Oppression" is not defined in the BOC (nor was it defined in the predecessor TBCA), but the First District Court of Appeals in the seminal case of *Davis v. Sheerin* proffered a broad definition of "oppression" and held that a court could fashion equitable remedies other than receivership, including a court-ordered buyout of the oppressed party, to redress oppressive conduct. *Davis v. Sheerin*, 754 S.W.2d 375 (Tex. App.—Houston [1st Dist.] 1988, writ denied). Although the application of the oppression doctrine in *Davis* did not go totally unnoticed in the early aftermath of the *Davis* case, litigation involving oppression claims has increased significantly in recent years, and shareholder oppression has become a "hot topic" in the law of closely held businesses. *See* Ladd A. Hirsch, *A Way Out for Minority Investors in Private Texas Companies*, TODAY'S CPA, Sept./Oct. 2011, at 30 (which includes a case study that appears to be based on an oppression case tried in Dallas County in which a minority shareholder obtained a judgment compelling payment of an $85,000,000 dividend and other relief as described in the judgment entered in *Shagrithaya v. Martin*, No. 07-15149-I, available at 2010 WL 1619678 (subsequently reversed by the Dallas Court of

Appeals in *ARGO Data Res. Corp. v. Shagrithaya*, 380 S.W.3d 249 (Tex. App.—Dallas 2012, pet. filed)). The Texas Supreme Court has not addressed "oppression" *per se*, but *Patton v. Nicholas*, 154 Tex. 385, 279 S.W.2d 848 (1955), in which the Texas Supreme Court held that malicious suppression of dividends was a wrong justifying injunctive relief mandating the payment of dividends, has been cited in support of the authority of courts to fashion equitable relief for oppressive conduct, as further discussed below. The Texas Supreme Court heard oral argument earlier this year in the shareholder oppression case of *Ritchie v. Rupe*, 339 S.W.3d 275 (Tex. App.—Dallas 2011, pet. granted). As this paper is being written, the court has not yet issued its opinion in that case, but its opinion will obviously be a major development in this area of Texas law.

### B. Definition of "Oppression" and Availability of Remedies Other Than Receivership

The definition of "oppression" adopted by the First Court of Appeals in *Davis v. Sheerin* and generally followed by other courts of appeals in Texas is:

> (1) majority shareholders' conduct that substantially defeats the minority's expectations that, objectively viewed, were both reasonable under the circumstances and central to the minority shareholder's decision to invest; or
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> (2) burdensome, harsh, or wrongful conduct; a lack of probity and fair dealing in the company's affairs to the prejudice of some members; or a visible departure from the standards of fair dealing and a violation of fair play on which each shareholder is entitled to rely.

*Davis v. Sheerin*, 754 S.W.2d 375, 381-82 (Tex.App.—Houston [1st Dist.] 1988, writ denied)(awarding minority shareholder equitable buyout at fair value as determined by jury based upon the majority's refusal to recognize the minority's ownership in the corporation); *see also Ritchie v. Rupe,* 339 S.W.3d 275 (Tex.App.–Dallas 2011, pet. granted); *Kohannim v. Katoli*, __ S.W.3d __, 2013 WL 3943078 (Tex.App.–El Paso 2013, pet. denied); *Boehringer v. Konkel*, 404 S.W.3d 18 (Tex.App.–Houston [1st Dist.] 2013, no pet.); *Redmon v. Griffith*, 202 S.W.3d 225, 234 (Tex.App.–Tyler 2006, pet. denied); *Cotten v. Weatherford Bancshares, Inc.*, 187 S.W.3d 687, 699-700 (Tex.App.–Fort Worth 2006, pet. denied); *Willis v. Bydalek*, 997 S.W.2d 798, 801 (Tex. App.—Houston [1st Dist.] 1999, pet. denied); *Gibney v. Culver*, No. 13-06-112-CV, 2008 WL 1822767, *16-17 (Tex.App.–Corpus Christi 2008, pet. denied); *In re White*, 429 B.R. 201 (Bankr. S.D. Tex. 2010). Courts in some cases have commented that a minority shareholder's reasonable expectations must be balanced with the corporation's need to exercise its business judgment and that a corporation's officers and directors are afforded rather broad latitude in conducting corporate affairs despite the majority's duty to the minority. *Willis v. Bydalek*, 997 S.W.2d 798, 801 (Tex.App.—Houston [1st Dist.] 1999, pet. denied) (holding that firing of shareholder who was at-will employee did not amount to oppression under the circumstances present in that case); *Gibney v. Culver*, No. 13-06-112-CV, 2008 WL 1822767, *17 (Tex.App.–Corpus Christi 2008, pet. denied) (holding that plaintiff failed to establish oppression with respect to payment of dividends or access to corporation's books and records). In *Allen v. Devon Energy Holdings, L.L.C.*, 367 S.W.3d 355 (Tex. App.–Houston [1st Dist.] 2012, pet. granted, judgm't vacated w.r.m.), the court stated that the allegations of "wrongful conduct" of fraud and breach of fiduciary duty in connection with the redemption of a minority owner's interest were not similar to the previously recognized examples of shareholder oppression in the case law (listing termination of employment, denial of access to books and records, wrongful withholding of dividends, waste of corporate funds, excessive compensation, lock-out from corporate offices, and squeeze-out as examples of "typical wrongdoing in shareholder oppression cases") and that the minority owner cited no case allowing fraud or breach of fiduciary duty to be the basis of a shareholder oppression claim. Thus, the court upheld summary judgment against the minority owner on his oppression claim. A relatively comprehensive survey of shareholder and member oppression cases in Texas is set forth in Elizabeth S. Miller, *Shareholder and LLC Member Oppression in Texas*, presented at State Bar of Texas Choice and Acquisition of Entities in Texas, May 24, 2013, available on the author's profile page at http://www.baylor.edu/law.

A detailed analysis and expansive application of the shareholder oppression doctrine is found in the case of *Ritchie v. Rupe,* 339 S.W.3d 275 (Tex. App.–Dallas 2011, pet. granted). The court of appeals in that case reasoned that management's refusal to make itself available to prospective buyers of the plaintiff's shares substantially defeated the reasonable expectation of the shareholder in being able to sell her shares and constituted a lack of fair dealing since there is no ready market for the stock of a closely held corporation and an investor would not be willing to purchase that type of stock without interviewing management. The court held that a buyout of the minority shareholder's stock was an appropriate remedy, but that discounts for lack of marketability and lack of control should be applied in valuing the stock for purposes of the buyout in these circumstances. The court acknowledged that a minority shareholder's reasonable expectations must be balanced with the corporation's need to exercise its business judgment, and the court implicitly recognized some of the concerns that would arise in subjecting management to interviews by prospective purchasers of a shareholder's stock, but the court stated that the defendants expressed only a "general and nonspecific fear of litigation" as a justification for their refusal to meet with prospective purchasers of the shareholder's stock and that the flat refusal of the defendants to meet with prospective purchasers was unwarranted. Another panel of the Dallas Court of Appeals applied the definition of oppression in a much more restrained manner in a lengthy and detailed opinion in *ARGO Data Resource Service, Inc. v. Shagrithaya*, 380 S.W.3d 249 (Tex. App.–Dallas 2012, pet. filed) (reversing and rendering trial court's judgment in case where majority shareholder significantly reduced minority shareholder's compensation and retained millions of dollars in earnings rather than paying larger dividends).

As explained in the court of appeals' decision in *Ritchie v. Rupe*, the rationale for allowing courts to fashion remedies other than receivership for oppressive conduct is that the receivership statute specifies that a court may appoint a receiver under the circumstances specified in the statute (including oppression) "only if…the court determines that all other available legal and equitable remedies…are inadequate." Tex. Bus. Orgs. Code § 11.404(b)(3); *Ritchie v. Rupe*, 339 S.W.3d 275, 285-86 (Tex. App.—Dallas 2011, pet. granted). This language has been interpreted as suggesting that the courts have authority to fashion equitable remedies that are less drastic than receivership to redress oppressive conduct. *Ritchie*, 339 S.W.3d at 285-86; *Four Seasons Equip., Inc. v. White (In re White*), 429 B.R. 201, 214-15 (Bankr. S.D. Tex. 2010). Further, as discussed in *Davis v. Sheerin, Ritche v. Rupe*, and *In re White*, the Texas Supreme Court recognized a court's equitable power to fashion a remedy for wrongful conduct of a majority shareholder in *Patton v. Nicholas*, a case predating the TBCA.

In *Patton v. Nicholas*, 154 Tex. 385, 279 S.W.2d 848 (1955), the Texas Supreme Court analyzed the remedies available where the majority shareholder exercised control of a corporation for the malicious purpose, and with the actual result, of preventing dividends and otherwise lowering the current market value of the minority's stock. Acknowledging that the receivership statutes at that time (unlike the TBCA provisions that took effect later in the same year in which the case was decided) dealt only with insolvent corporations or did not include any explicit reference to grounds encompassing a situation like that at issue, the supreme court nevertheless concluded that Texas courts had the general equity power to appoint a liquidating or rehabilitative receiver in extreme cases of the type presented. The court stated, however, that "[w]isdom would seem to counsel tailoring the remedy to fit the particular case." In accordance with this policy, the supreme court determined that the outright liquidation and receivership decreed by the lower courts should be eliminated and replaced with a new injunctive decree mandating the payment of reasonable dividends and giving the trial court continuing jurisdiction to monitor compliance and ensure protection of the minority's rights, with the prospect of immediate liquidation of the corporation if it should in any manner be operated in bad faith toward the decree or the minority. The court characterized this new decree as giving adequate protection to the minority while affording both parties a chance to normalize their relationships.

Although *Patton v. Nicholas* and the current receivership statute may be understood as authorizing a Texas court to fashion a non-traditional equitable remedy (such as a buyout) for oppression consisting of a statutorily or traditionally recognized cause of action, or even to fashion an equitable remedy for conduct that is not statutorily or traditionally actionable outside the receivership statute (such as "oppressive" acts that do not violate a specific statute or constitute a traditional common-law breach of duty), it might be argued that the "other available legal and equitable remedies" referred to in the current receivership statutes should generally be understood as confined to traditional types of relief available to redress conduct that otherwise constitutes a recognized cause of action under law independent of the receivership statute, and that a receivership is the only remedy authorized for any conduct that is described as grounds for a receivership if the conduct does not otherwise constitute an independent cause of action.

### C. Application of Shareholder Oppression Doctrine to LLC Members

The shareholder oppression doctrine has been asserted and applied in the LLC context. For example, in the recent case of *Kohannim v. Katoli*, __ S.W.3d __, 2013 WL 3943078 (Tex.App.–El Paso 2013, pet. denied), an assignee of a 50% membership interest in an LLC (by virtue of the award of her husband's interest to her in a divorce) asserted an oppression claim against the other 50% member. The court of appeals rejected the defendant's challenge to the legal sufficiency of the evidence to support the plaintiff's oppression claim. The court of appeals stated that "a member oppression claim may exist when: (1) a majority shareholder's conduct substantially defeats the minority's expectations that objectively viewed, were both reasonable under the circumstances and central to the minority shareholder's decision to join the venture; or (2) burdensome, harsh, or wrongful conduct, a lack of probity and fair dealing in the company's affairs to the prejudice of some members, or a visible departure from the standards of fair dealing, and a violation of fair play on which every shareholder who entrusts his money to a company is entitled to rely." The defendant contended that an oppression claim can only be asserted by a minority member or shareholder, and the plaintiff owned a 50% interest. The court of appeals rejected the argument that only a minority owner may assert an oppression claim, stating that the BOC provides for a receivership based on oppression by the directors or "those in control" of the entity. The court of appeals went on to examine whether there was any evidence of oppressive acts. The defendant argued that there was no evidence that he oppressed the plaintiff's rights by refusing to allow her to participate in management given that she was not a member. The court explained that a membership interest is personal property and that the 50% membership interest of the plaintiff's ex-husband was community property awarded in its entirety to the plaintiff under the divorce decree. The plaintiff's ex-husband executed a document transferring and assigning the membership interest to the plaintiff as required by the divorce decree, but the assignment of the interest did not include the right to participate in management under the BOC. Under the statute, the right to participate in management is not community property, and assignment of a membership interest does not entitle the assignee to participate in the management and affairs of the LLC, become a member, or exercise any rights of a member. An assignee is entitled to become a member only with the approval of all of the members, and the defendant never consented to the plaintiff becoming a member. Thus, the plaintiff did not have any right to participate in the management of the LLC. The defendant next contended that there was no evidence that he oppressed the plaintiff's rights by failing to make distributions to her. The LLC's regulations provided for quarterly distributions to members of "available cash" provided available cash was not needed for reasonable working capital reserves. The BOC provides that an assignee is entitled to receive any distribution the assignor is entitled to receive to the extent the distribution is assigned. Because the district court awarded the entire community interest to the plaintiff, she had a right to receive distributions. The district court found that the defendant paid himself for services that were not performed and that he failed to make any distributions to the plaintiff or her ex-husband even though $250,000 in undistributed profits had accumulated since the mortgage on the LLC's property was paid off. The court of appeals concluded this was some evidence supporting the trial court's finding that the defendant failed to make profit distributions. The court also agreed that the established facts demonstrated that the defendant engaged in wrongful conduct and exhibited a lack of fair dealing to the prejudice of the plaintiff.

With respect to the defendant's challenge to the sufficiency of the evidence to support the court's damage award, the court of appeals stated that the standard of review was not the traditional sufficiency analysis as asserted by the defendant, but rather was abuse of discretion because the receivership provision of the BOC that provides for an oppression action authorizes a court to fashion an equitable remedy if the acts of those in control of an entity are oppressive. The court of appeals concluded that the trial court's methodology for finding actual damages was not an abuse of discretion. The trial court calculated the plaintiff's damages by calculating the difference between the value of the LLC's assets at the time of the trial court's judgment in this case and the value of the LLC at the time of the divorce, increased by the amount taken from the LLC's bank account by the defendant before the divorce decree. The court of appeals rejected the defendant's argument that the trial court erred by adding back the amount taken from the LLC's bank account prior to the divorce. Because the defendant's removal of the LLC's funds reduced the value of the plaintiff's interest, the court of appeals concluded the trial court did not err by adding that amount back into the value of the LLC. The defendant argued that the LLC regulations provided that the valuation of the plaintiff's interest must be based on book value because the regulations contained a provision for purchase of a member's interest at book value or appraised value on request of a party who deems the book value to vary from market value by more than 20%. The provision of the regulations relied upon by the defendant addressed death, dissolution, retirement, or bankruptcy of a member. The court stated that the provision did not address how damages are calculated in a lawsuit based on oppression, and the court relied on other case law in which the court in an oppression action concluded that it was not an abuse of discretion to order a buyout for fair value when a buy-sell agreement provided for redemption at book value. The court of appeals pointed out that receivership is one remedy for shareholder/member oppression and that the trial court ordered a receivership and authorized a sale of the LLC's assets. The defendant did not complain concerning the receivership or sale. However, the court concluded that the plaintiff was not limited to a recovery of her proportionate share of the sale proceeds and that courts have equitable powers to fashion appropriate remedies for oppressive conduct, including a buyout. Here, the court concluded that sufficient evidence supported the values found by the trial court and that the defendant did not argue, and the court of appeals did not perceive, that the trial court's methodology constituted an abuse of discretion.

In *Allen v. Devon Energy Holdings, L.L.C.* 367 S.W.3d 355 (Tex. App.—Houston [1st Dist.] 2012, pet. granted, judgm't vacated w.r.m.), the court stated that the allegations of "wrongful conduct" of fraud and breach of fiduciary duty in connection with the redemption of a minority member's interest were not similar to previously recognized examples of shareholder oppression in the case law (listing termination of employment, denial of access to books and records, wrongful withholding of dividends, waste of corporate funds, excessive compensation, lock-out from corporate offices, and squeeze-out as examples of "typical wrongdoing in shareholder oppression cases") and that the minority member cited no case allowing fraud or breach of fiduciary duty to be the basis of a shareholder oppression claim. The court stated in a footnote that it was expressing no opinion as to whether the shareholder oppression doctrine applies in the LLC context.

In *Pinnacle Data Services, Inc. v. Gillen*, 104 S.W.3d 188 (Tex. App.–Texarkana 2003, no pet.), a member of an LLC sued the other two members alleging various causes of action. The court apparently accepted that an LLC member may bring a claim for "member oppression." The court defined "member oppression" by setting forth the definition of shareholder oppression from *Davis v. Sheerin*, but the court upheld summary judgment in favor of the defendants on the oppression claim, stating that the plaintiff had failed to set forth any evidence in support of its oppression claim.