

PRESENTED AT

43rd Annual Corporate Counsel Institute

April 28-30, 2021

Virtual, TX

Fraud Is Now Legal in Texas (for Some People)

Val Ricks

Author Contact Information:

Val Ricks

South Texas College of Law Houston

Houston, TX

vricks@stcl.edu

713-646-2944

ARTICLES

FRAUD IS NOW LEGAL IN TEXAS (FOR SOME PEOPLE)

by: Val Ricks*

ABSTRACT

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

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

TABLE OF CONTENTS

I. INTRODUCTION.....	2
II. THE STATUTE.....	5
III. THE HOUSTON CASES.....	8
A. TecLogistics.....	8
B. Hong v. Havey.....	17
1. Subsection (a)(2).....	18
2. Subsection (b).....	19
IV. COUNTERARGUMENTS.....	21
A. <i>The Court's Misreading</i>	21
1. The Law of Statutes.....	21
3. The New Anomaly That Is Subsection (b).....	28
4. Legislative Intent.....	30

DOI: <https://doi.org/10.37419/LR.V8.II.1>

* Professor of Law, South Texas College of Law Houston. The Author thanks Glenn West for helpful discussions of several related issues.

B.	<i>Unexpected and Unwanted Results: When No One Is Liable for Fraud</i>	37
1.	Whither Vicarious Liability	37
2.	The Gap Between the Statute and Any Vicarious Liability	40
3.	The Insolvent Corporation	43
C.	<i>More Unintended Results, Including the Corporation's Loss of Rights</i>	44
1.	Exempting Fraud but Not Negligence	44
2.	Shareholders and Affiliates Who Commit Fraud Against the Corporation	45
3.	No Indemnity or Contribution from the Corporate Actor	46
4.	Employee Exemption from Fraud, or Immunity for the Price of a Share	50
5.	Dis the Partnership	52
D.	<i>No Way to Contract Around</i>	53
V.	JUSTIFICATION	53
A.	<i>An Exemption from Tort Law</i>	53
B.	<i>An Unequal Exemption</i>	56
C.	<i>What the Commentators Say</i>	56
VI.	CONCLUSION	60

I. INTRODUCTION

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

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

1. The cases are *Hong v. Havey*, 551 S.W.3d 875 (Tex. App.—Houston [14th Dist.] 2018, no pet.), and *TecLogistics, Inc. v. Dresser-Rand Group, Inc.*, 527 S.W.3d 589 (Tex. App.—Houston [14th Dist.] 2017, no pet.). The recent El Paso case is *Valley Forge Motor Co. v. Sifuentes*, 595 S.W.3d 871 (Tex. App.—El Paso 2020, no pet.). Another case was decided in 2001 in Texarkana. *Texas-Ohio Gas, Inc. v. Mecom*, 28 S.W.3d 129 (Tex. App.—Texarkana 2000, no pet.). A federal district court in Dallas also adopted the position in an unpublished decision. *See Saeed v. Bennett-Fouch Assocs., LLC*, No. 3:11-cv-01134-F, 2012 WL 13026741, at *2–4 (N.D. Tex. Aug. 28, 2012).

corporation's contract counterparty has sued the corporation² but also sued the corporate actor for fraud. The personal claim may be motivated by vendetta, leverage, or justice and a hope of recovery, but usually the corporate actor and her attorney believe the corporate actor should not be sued individually for something she did as part of her job. As nearly as I can tell (see Part V), and based on endorsements from practicing attorneys, the courts' reading of the statute is an attempt to support the understanding of the corporate actor's lawyer.

These courts claim to be following a statute (set out in Part II) that on its face addresses veil-piercing.³ The courts claim that the legislature slipped some language in without fanfare or announcement (or even suggestion⁴) in 1997 that *actually* creates a broad immunity from liability for fraud connected to a contract in any way by anyone in the named group of business actors.⁵ No court seemed to notice this provision until 2001 (the Texarkana case),⁶ and after that not until 2017, when a Houston intermediate appellate court decided to adopt this immunity in a case in which it had not been argued by counsel.⁷ I describe the Houston cases in detail in Part III. They were decided by the 14th Court of Appeals, called affectionately here "the 14th." The 14th's opinions are the most cogent defense of this new position—this reading of the statute. Now the El Paso appellate court has decided to follow the 14th. The court of appeals in Corpus Christi (and perhaps the one in San Antonio) has declined to follow.⁸ The Supreme Court of Texas will probably decide the issue. One judge who signed on in the 14th now sits on the Supreme Court of Texas (Busby).⁹ Perhaps this theory will cover all of Texas.

2. Except in the El Paso case in which only the individual was sued. See *Sifuentes*, 595 S.W.3d at 871.

3. TEX. BUS. ORGS. CODE ANN. §§ 21.223–.225 (West 2019).

4. Nothing in the bill analysis of the 1997 amendments mentions anything like this. See House Comm. on Bus. & Indus., Bill Analysis, Tex. S.B. 555, 75th Leg., R.S. (1997). The introduced, Senate, and House bill analyses are all equally bland and empty in this respect. All are available at Texas Legislature Online.

5. See *Sifuentes*, 595 S.W.3d at 877–78; *Havey*, 551 S.W.3d at 883; *TecLogistics*, 527 S.W.3d at 599–600.

6. See *Mecom*, 28 S.W.3d at 136–38.

7. See *TecLogistics*, 527 S.W.3d at 603. The Houston opinions do not mention *Mecom*, 28 S.W.3d at 129, the case from Texarkana.

8. See *Kingston v. Helm*, 82 S.W.3d 755, 764–67 (Tex. App.—Corpus Christi—Edinburg 2002, pet. denied); see also *Sanchez v. Mulvaney*, 274 S.W.3d 708, 712 (Tex. App.—San Antonio 2008, no pet.) (purporting to follow *Kingston* to impose individual liability). A federal district court in Dallas also declined to follow the position, after a detailed discussion. See *Bates Energy Oil & Gas v. Complete Oilfield Servs.*, 361 F. Supp. 3d 633, 664–74 (W.D. Tex. 2019). *Bates* contains a particularly thoughtful discussion of Texas precedent. See *id.*

9. See *Supreme Court*, TEX. JUD. BRANCH, <https://www.txcourts.gov/supreme/about-the-court/> [<https://perma.cc/LKN3-VDK7>]. Justice Busby did not write but sat on the panel that decided *TecLogistics*.

Find the full text of this and thousands of other resources from leading experts in dozens of legal practice areas in the [UT Law CLE eLibrary \(utcle.org/elibrary\)](https://utcle.org/elibrary)

Title search: Fraud Is Now Legal in Texas (for Some People)

Also available as part of the eCourse
[2021 Corporate Counsel eConference](#)

First appeared as part of the conference materials for the
43rd Annual Corporate Counsel Institute session
"Fraud Is Now Legal in Texas (for Some People)"