

SUBJECT: Applying limited liability for corporations to limited liability companies

COMMITTEE: Business and Industry — favorable, without amendment

VOTE: 8 ayes — Deshotel, Elkins, Christian, England, Giddings, S. Miller, Orr, Quintanilla

0 nays

3 absent — Gattis, Keffer, S. Turner

SENATE VOTE: On final passage, April 9 — 31-0, on Local and Uncontested Calendar

WITNESSES: (*On House companion bill, HB 3624:*)
For — (*Registered, but did not testify:* Elizabeth Miller)

Against — None

BACKGROUND: Under Business Organizations Code, sec. 21.223, a holder of shares, an owner of any beneficial interest in shares, or a subscriber for shares whose subscription has been accepted, or any affiliate of such a holder, owner, or subscriber or of the corporation, may not be held liable to the corporation or its obligees with respect to:

- the shares, other than the obligation to pay the corporation the full amount of consideration, fixed in compliance with secs. 21.157-21.162, for which the shares were or are to be issued;
- any contractual obligation of the corporation or any matter relating to an obligation on the basis that the holder, beneficial owner, subscriber, or affiliate is or was the alter ego of the corporation or on the basis of actual or constructive fraud, a sham to perpetrate a fraud, or other similar theory, or
- any obligation of the corporation on the basis of the failure of the corporation to observe any corporate formality.

Under sec. 21.224, the liability of a shareholder or an affiliate of the shareholder for a limited liability obligation is exclusive and preempts any other liability imposed for that obligation.

Under sec. 21.225, the limitation on liability can be suspended if a person:

- expressly assumes, guarantees, or agrees to be liable to the obligee for the obligation; or
- is otherwise liable to the obligee for the obligation under any applicable law.

Under sec. 21.226, a pledgee or other holder of shares as collateral security is not personally liable as a shareholder. An executor, administrator, conservator, guardian, trustee, assignee for the benefit of creditors, or receiver is not personally liable as a holder of or subscriber to shares of a corporation. The estate and funds administered by an executor, administrator, conservator, guardian, trustee, assignee for the benefit of creditors, or receiver are liable for the full amount of the consideration for which the shares were issued.

Under the Texas Limited Liability Company Act, VTCS, art. 8.12, certain provisions of the Texas Business Corporations Act regarding liability apply to limited liability companies and their members, managers, and officers.

DIGEST:

SB 1773 would align the standards for piercing the liability shield of limited liability companies with the standards used to pierce the liability shield of corporations. SB 1773 would amend Business Organizations Code, ch. 101, subch. A, to direct that sec. 21.223 (limitation on liability for obligations of corporations, officers, and shareholders); sec. 21.224 (preemption of liability); sec. 21.225 (exceptions to limitations on liability); and sec. 21.226 (liability of pledgees and trust administrators) would apply to an LLC and its members, owners, assignees, and subscribers.

SB 1773 would create several definitions that would be used to apply the rules for piercing a corporation's limited liability protections to an LLC. A reference to:

- "shares" would include "membership interests";
- "holder," "owner," or "shareholder" would include a "member" and an "assignee";
- "corporation" or "corporate" would include a "limited liability company";

- “directors” would include “managers” of a manager-managed limited liability company and “members” of a member-managed limited liability company;
- “bylaws” includes “company agreement”; and
- to “Sec. 21.157-21.162” in sec. 21.223(a)(1) would refer to the provisions of subch. D of ch. 101.

SB 1773 also would amend the Texas Limited Liability Company Act, VTCS, art. 1528n, to apply art. 2.21 (Designation of Officers; Authority and Apparent Authority of Officers, Agents, Managers, and Members) to a limited liability company and its members, managers, and officers.

The bill would take effect on September 1, 2009.

**SUPPORTERS
SAY:**

Current law is silent as to what standards a court should use to determine whether an LLC’s limited-liability protections should be pierced and whether the LLC’s stakeholders should be held personally responsible for the obligations of the LLC. SB 1773 would provide clarification to the law by making clear that standards for piercing the corporate veil that currently apply to corporations also would apply to LLCs. SB 1773 would provide no more or less protection to LLCs than current law grants to corporations.

Under current law, which does not address how the limited-liability protections of an LLC can be breached, there is a wide divergence of opinion by legal experts on how it can be done. Some say that because LLCs are less formal than corporations, the rules for piercing their limited-liability protections should meet lower standards than those that apply to corporations. Other experts have said that, because the law is silent on piercing the limited-liability protections of corporations, the law does not allow it to be done. SB 1773 would take a middle-of-the-road approach by directing courts to use the same rules currently applied to corporations to LLCs as well.

While courts inside and outside of Texas have started to apply standards used for corporations when addressing the limited-liability protections of LLCs, they have done so with little discussion of how and why they are doing so. SB 1773 would resolve this ambiguity by making established guidelines for corporations applicable to LLCs as well.

Texas created LLCs to allow groups that could not incorporate to enjoy some of the same desirable legal protections provided by to a corporation

under Texas law. It would be appropriate to use the rules for piercing the limited-liability of corporations for analogous situations involving LLCs because the established body of case law shows that courts know how to apply these standards and are comfortable doing so.

**OPPONENTS
SAY:**

LLCs are inherently less formal than corporations and should not enjoy all the same liability protections that corporations have. It should be easier to pierce an LLC's limited-liability protections than it is to pierce those of a corporation. If the stakeholders of an LLC desire the same protections of a corporation, they should incorporate or the Legislature should establish a separate set of standards for piercing limited liability protections for LLCs.

NOTES:

The House companion bill, HB 3624 by Elkins, was considered in a public hearing by the Business and Industry Committee on April 8 and left pending.