SUBJECT: Applying limited liability for corporations to limited liability companies

COMMITTEE: Business and Industry — favorable, without amendment

VOTE: 7 ayes — Deshotel, Orr, Bohac, Garza, Quintanilla, Solomons, Workman

0 nays

2 absent — Giddings, S. Miller

WITNESSES: For — Val Perkins, Texas Business Law Foundation; (*Registered, but did not testify:* Mike Barnett, Texas Association of Realtors; David Mintz, Texas Apartment Association)

Against — None

BACKGROUND: Under Business Organizations Code, sec. 101.114, a member or manager of a limited liability company (LLC) is not liable for a debt, obligation, or liability of the LLC, unless the company agreement specifies otherwise.

Under sec. 21.223, a holder of shares, a beneficial owner, or a subscriber for shares whose subscription has been accepted, or any affiliate of such a party or affiliate of a corporation, may not be held liable to the corporation or its obligees regarding:

- 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 limited-liability protections of sec. 21.223 pre-empt 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 personally 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 any of such parties are liable for the full amount of the consideration for which the shares were or are to be issued.

DIGEST:

HB 521 would align the standards for piercing the liability shield of limited liability companies with the standards used to pierce the liability shield ("corporate veil") of corporations. HB 521 would amend the Business Organizations Code to direct that secs. 21.223 (limitation of liability for shareholders), 21.224 (pre-emption of liability), 21.225 (exceptions to limitations on liability), and 21.226 (liability of pledgees and trust administrators) would apply to an LLC and its members, owners, assignees, affiliates, and subscribers.

HB 521 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" would include "company agreement"; and
- to "Sections 21.157-21.162" in sec. 21.223(a)(1), relating to shares, would refer to the provisions of subch. D of ch. 101, relating to contributions.

The bill would take effect on September 1, 2011.

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. HB 521 would clarify that standards for piercing the corporate veil that currently apply to corporations also would apply to LLCs. HB 521 would provide no more or less protection to LLCs than current law grants to corporations.

Two out-of-state courts recently held that the liability shield for an LLC is less protective than that of a for-profit corporation. These rulings are of serious concern for the thousands of current Texas LLCs and could impact the decisions of prospective businesses weighing whether to move to Texas. Texas case law has supported the alternative position, that state law principles for piercing the corporate veil of corporations should be applied to LLCs. HB 521 would clarify in statute that the standards for piercing the liability shield of a corporation apply equally to an LLC.

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

OPPONENTS SAY:

LLCs are inherently less formal than corporations and should not enjoy all the same liability protections that corporations do. It should be easier to pierce an LLC's limited-liability protections than 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 companion bill, SB 323 by Carona, passed the Senate by 31-0 on the Local and Uncontested Calendar on March 17 and was reported favorably, without amendment, by the House Business and Industry Committee on April 13.

During the 2009 regular session, a similar bill, SB 1773 by Fraser, passed the Senate by 31-0 and was placed on the General State Calendar, but the House took no further action.