

Texas Supreme Court Holds Shareholder Not Liable for Corporation's Contractual Obligations.

Willis v. Donnelly, Texas Supreme Court Case No. 04-0409 (June 2, 2006)
<http://www.supreme.courts.state.tx.us/historical/2006/jun/040409.htm>.

This is a good case for the protection of corporate shareholders from contractual corporate debt and reaffirms our understanding of the statutory provisions in the Texas Business Corporation Act (Act), and the Texas Business Organizations Code (TBOC) which recodifies the Act. In *Willis*, the Texas Supreme Court confirmed the “bedrock principal” that an individual can incorporate a business and thereby normally shield himself from personal liability for the corporation’s contractual obligations. More importantly, the Court rejected the argument that a shareholder was liable for the corporation’s contractual obligation based upon the theory that the shareholder had ratified the agreement by impliedly agreeing to be bound by the agreement or by accepting benefits under the agreement.

The dispute involved a letter agreement. The opening sentence of the letter agreement states that it is “a letter agreement between [WHE], Richard H. Hite, Mike Willis, and [URH], and Daniel Donnelly and {Hairmasters}.” WHE and URH were two corporations organized by Willis and others. A signature block at the end of the letter agreement was typed in for “Mike Willis, Individually,” but Willis refused to sign the letter agreement in his individual capacity and crossed out his signature block. Willis made it clear that he did not want to be individually responsible for the performance of the letter agreement, and Donnelly signed the letter agreement after Willis removed himself as an individual signatory to the letter agreement.

Donnelly asserted that Willis and his wife were liable under the letter agreement because they had ratified it by accepting benefits under the agreement. The jury found that WHE and URH breached the letter agreement by failing to issue the stock to Donnelly, and that Willis and his wife had ratified and were individually liable under the letter agreement. The court of appeals also held that Willis and his wife had ratified the letter agreement and were liable under it.

The Supreme Court, however, found that Willis and his wife were not liable for breach of the agreement under the undisputed facts presented. Willis was not a party to the letter agreement, had struck through his signature block and refused to sign it. The Court said:

A bedrock principle of corporate law is that an individual can incorporate a business and thereby normally shield himself from personal liability for the corporation’s contractual obligations. Avoidance of personal liability is not only sanctioned by the law; it is an essential reason that entrepreneurs like Willis choose to incorporate their businesses.

The Court also noted the statute provides that a shareholder “may not be held liable to the corporation or its obligees with respect to . . . any contractual obligation of the corporation . . . on the basis that the holder . . . 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*” There is a statutory exception to this rule where the shareholder caused the corporation to be used for the purpose of perpetrating and did perpetuate an actual fraud on the obligee primarily for the benefit

of the shareholder. The jury, however, rejected Donnelly's fraud claim. There is also a statutory exception for when the shareholder expressly agrees to be personally liable to the obligee for the obligations, but the Court said it could not find any evidence that Willis and his wife expressly agreed to assume personal liability under the letter agreement.

The Court then disposed of Donnelly's ratification argument by saying the following:

To impose liability against the Willises under a common law theory of implied ratification because they accepted the benefits of the letter agreement would contravene the statutory imperative that, absent actual fraud or an express agreement to assume personal liability, a shareholder may not be held liable for contractual obligations of the corporation. We hold that characterizing the theory as "ratification" rather than "alter ego" is simply asserting a "similar theory" of derivative liability that is covered by the statute.

This case only addresses a shareholder's liability for a corporation's contractual obligations. There is no statute similar to the one cited by the Court that limits a shareholder's liability for the corporation's negligence or misconduct, and there are common law theories that allow piercing the corporate liability shield under certain circumstances to impose shareholder liability for the corporation's negligence or misconduct. We will reserve a discuss of that area for later.