2011 LEGISLATIVE UPDATE: AMENDMENTS TO THE TEXAS BUSINESS ORGANIZATIONS CODE AND TEXAS BUSINESS AND COMMERCE CODE

LEGISLATIVE CHANGES AFFECTING BUSINESS ENTITIES WEBCAST
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From Austin, Texas
July 13, 2011

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LEGISLATIVE UPDATE: 2011 AMENDMENTS TO THE TEXAS BUSINESS ORGANIZATIONS CODE

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I. Introduction and Background

This article summarizes several pieces of legislation that were passed by the Texas Legislature in its 2011 Regular Session and that amend the Texas Business Organizations Code ("*TBOC*" or the "*Code*"). This article also summarizes two pieces of legislation that were passed by the Texas Legislature in its 2011 Regular Session and that amend the Texas Business & Commerce Code ("*TBCC*").

Senate Bill 748 ("*S.B. 748*") was authored by Senator John Carona, sponsored by Representative Helen Giddings, signed into law by Governor Rick Perry on May 27, 2011 and becomes effective on September 1, 2011. S.B. 748 makes numerous technical and substantive amendments to the Code.

Senate Bill 1568 ("*S.B. 1568*") was authored by Senator Craig Estes, sponsored by Representative Gary Elkins, signed into law by the Governor on May 19, 2011 and becomes effective on September 1, 2011. S.B. 1568 removes a subsection relating to a shareholder's standing to continue a derivative action on behalf of a for-profit corporation.

Senate Bill 323 ("*S.B. 323*") was authored by Senator John Carona, sponsored by Representative Gary Elkins, signed into law by the Governor on May 9, 2011 and becomes effective on September 1, 2011. S.B. 323 incorporates into the limited liability company provisions of the Code the Code's provisions relating to protection from liability of shareholders for the obligations of a for-profit corporation.

Senate Bill 582 ("*S.B. 582*") was authored by Senators Chris Harris and Kirk Watson, sponsored by Representative Tyron Lewis, signed into law by the Governor on April 21, 2011 and becomes effective on September 1, 2011. S.B. 582 amends the Code to add limited liability companies to the special service of process provisions relating to political subdivisions.

House Bill 2047 ("*H.B. 2047*") was authored by Representative Tyron Lewis, sponsored by Senator Carlos Uresti, signed into law by the Governor on June 17, 2011 and becomes effective on September 1, 2011. H.B. 2047 amends the Code to specify that any employee of an organization that is a registered agent may receive service of process at the registered office.

House Bill 2098 *("H.B. 2098")* was authored by Representative John Davis, sponsored by Senator Carlos Uresti, signed in to law by the Governor on June 17, 2011, and became

[1] The author would like to acknowledge the contributions of Richard Tulli of Gardere Wynn Sewell LLP, Professor Elizabeth Miller of Baylor Law School, Byron Egan of Jackson Walker LLP, and Carmen Flores of the Office of the Texas Secretary of State for their contributions to various portions of this paper.

immediately effective upon signing. H.B. 2098 amends the Code as well as the Occupations Code to authorize the joint ownership of domestic entities by physicians and physician assistants.

As background information, the Code was originally adopted by the 2003 Texas Legislature. The Code codified the provisions of prior law (collectively referred to herein as the "*Previous Statutes*") found in the Texas Business Corporation Act ("*TBCA*"), Texas Non-Profit Corporation Act ("*TNPCA*"), Texas Miscellaneous Corporation Laws Act ("*TMCLA*"), Texas Limited Liability Company Act ("*TLLCA*"), Texas Revised Limited Partnership Act ("*TRLPA*"), Texas Real Estate Investment Trust Act ("*TREITA*"), Texas Uniform Unincorporated Nonprofit Associations Act ("*TUUNAA")*, Texas Professional Corporation Act ("*TPCA*"), Texas Professional Associations Act ("*TPAA*"), the Texas Revised Partnership Act ("*TRPA*"), the Cooperative Associations Act ("*CAA*") and other existing provisions of Texas statutes governing domestic entities.[2]

The effective date of the Code was January 1, 2006, and the Code applied to domestic (Texas) entities formed after that date. The Code generally did not apply prior to January 1, 2010 to a domestic entity that existed on or before January 1, 2006, unless the entity expressly elected to adopt the Code as its governing statute. On January 1, 2010, the Code began to apply to all domestic entities that existed on or before January 1, 2006.

Turning to the TBCC amendments, House Bill 2991 ("*H.B. 2991*") was authored by Representative Joe Deshotel, sponsored by Senator John Carona, signed into law by Governor Rick Perry on May 27, 2011 and becomes effective on September 1, 2011. H.B. 2991 updates and clarifies the TBCC's provisions relating to the ability of parties to a qualified transaction to choose the law of another jurisdiction to govern their transaction.

Senate Bill 782 ("*S.B. 782*") was authored by Senator John Carona, sponsored by Representative Joe Deshotel, signed into law by the Governor on May 17, 2011 and becomes effective on a delayed basis on July 1, 2013. S.B. 782 makes various amendments to Chapter 9 Secured Transactions of the TBCC, most of which are based on uniform amendments to the Uniform Commercial Code (the "*UCC*") approved at the national level.

II. S. B. 748 - General TBOC Amendments Bill

A. General Amendments

1. Execution of Written Consents

S.B. 748 eliminates language requiring that the reproduction of a written consent signed by an owner, member or governing person of a filing entity, in order to be a valid substitute for

[2] The Code was a joint project of the Business Law Section of the State Bar of Texas and the Office of the Texas Secretary of State. The Texas Legislative Council also assisted in the editing and drafting of the Code. The 2005 Texas Legislature passed House Bill 1156 containing numerous technical amendments to the Code. The 2007 Texas Legislature passed House Bill 1737 containing numerous technical amendments and several substantive amendments to the Code. The 2009 Texas Legislature passed Senate Bill 1442 containing numerous technical and substantive amendments to the Code.

the original writing, must consist of a complete reproduction of the entire original writing.[3] In practice, written consents in lieu of meetings are often provided through the use of counterpart signature pages, and it might be argued that the deleted language was inconsistent with this common practice.

2. Clarifications for Fundamental Business Transactions

S.B. 748 clarifies that a plan of merger can include the cancellation of ownership or membership interests.[4] In practice, ownership interests in mergers are often canceled as part of the merger in lieu of issuance of any consideration for those ownership interests. This practice is particularly common in mergers between parents and subsidiaries. This new clause provides express authority for such cancellation. The statutes of most other states, including Delaware, also contain express authority for such cancellation. Similarly, another change clarifies that an ownership or membership interest of a particular series or class may be canceled while other ownership or membership interests of the same class or series are converted or exchanged for other consideration as a result of a merger.[5] A conforming change is also made with respect to the effects of a merger to clarify that ownership or membership interests of an organization can be cancelled in accordance with a plan of merger.[6]

Section 21.453 is amended to add new subsections (f) and (g) authorizing (i) submission to the shareholders of a plan of conversion with a recommendation by the board that the shareholders not approve the plan of conversion and (ii) inclusion in the plan of conversion of a provision requiring its submission to shareholders even if the board of directors determines that the plan of conversion is not advisable and recommends against approval of the plan.[7] Subsections (f) and (g) are parallel to similar subsections contained in Section 21.452 with respect to a plan of merger and Section 21.454 with respect to a plan of exchange.

Code Section 1.002 is amended to add new definitions for "plan of conversion", "plan of exchange" and "plan of merger".[8] The three defined terms are used extensively in Chapter 10 and elsewhere in the Code and are defined simply to mean a document that conforms with the requirements applicable to the type of plan in specified sections in Chapter 10. The definitions do not specify any particular form or format for any such plan. Separate changes in each of the sections that contain the requirements for such plans clarify that the plans must be "in writing."[9]

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[3] S.B. 748 § 3 (to be codified at TBOC § 6.205(a)).

[4] S.B. 748 § 10 (to be codified at TBOC § 10.002(a)(6)). TBOC § 10.002 is also clarified by adding references to "or exchanging," "or exchange" or "or exchanged" in subsections (a)(5) and (c). Various provisions in Subchapter A of Chapter 10 refer to the conversion or exchange of ownership or membership interests. These additional references to "exchange" make the language more consistent.

[5] *Id*. (to be codified at TBOC § 10.002(c)).

[6] S.B. 748 § 11 (to be codified at TBOC § 10.008(a)(8)).

[7] S.B. 748 § 29.

[8] S.B. 748 § 1.

[9] S.B. 748 §§ 10, 12, 13 (to be codified at TBOC §§ 10.002(a), 10.052(a), 10.103(a)).

Another small change fills a gap in coverage by clarifying that an interest exchange with respect to a limited partnership will be treated in the same manner as a merger or conversion with respect to the right of a limited partner to vote for or against such a transaction without incurring personal liability.[10]

3. Conflict of Interest Transactions and Relationships

The Code contains various sections that establish similar safe-harbor approval procedures for contracts or transactions between a for-profit corporation, nonprofit corporation, real estate investment or limited liability company and one of its managerial officials (i.e., a governing person or officer).[11] These sections provide that an otherwise valid contract or transaction is valid notwithstanding the contract or transaction is between the entity and the managerial official or an entity in which the managerial official is also a managerial official or has a financial interest. Because of the cumulative impacts of various amendments to these Sections in past legislative sessions, the language has become less clear as to its meaning. One legal commentator has criticized the existing provisions as being unclear and susceptible to being construed as not providing the intended protections.[12] Legal practitioners have presumed that compliance with these statutory approval procedures would prevent the contract or transaction from being voided and protect the conflicted managerial official from claims for breach of duty.

To address the foregoing concerns, S.B. 748 restructures the provisions of each of these Sections to make more clear their intent. Provisions currently located in Subsection (b) of each of these Sections permitting the execution of a consent of governing persons, or the presence, participation or voting in the meeting of the governing authority, by the managerial official having the conflicting relationship or interest are moved to a new subsection (d). The previous location of this procedural language in the middle of the substantive provision in Subsection (b) caused confusion and led some to conclude that such Subsection was limited to only those circumstances that involved the managerial official's attendance at the meeting or execution of the authorizing consent.[13]

Subsection (a) of each of the Sections is amended to clarify that the applicable Section applies to affiliates or associates of the managerial official that has the conflicting relationship or interest.[14] While the former provisions were limited to a managerial official or organizations in which the managerial official has a financial interest or is a managerial official or a member, the provisions were broadly understood in practice to apply to a broad range of conflict of interest transactions or contracts. It is generally understood that a managerial official cannot avoid a conflict interest situation by simply causing his or her affiliate or associate (e.g. a spouse) to

[10] S.B. 748 § 52 (to be codified at TBOC § 153.103(9)(N)).
[11] *See* TBOC §§ 21.418, 22.230, 101.255 and 200.317.
[12] Professor Val D. Ricks, Vinson & Elkins Research Professor and Professor of Law, South Texas College of Law, "Texas' So-Called 'Interested Director' Statute," 50 *S. Tex. L. Rev.* 129 (Winter 2008).
[13] S.B. 748 §§ 28, 33, 38 and 57 (to be codified at TBOC §§ 21.418(d), 22.230(d), 101.255(d) and 200.317(d)).
[14] S.B. 748 §§ 28, 33, 38 and 57 (to be codified at TBOC §§ 21.418(a), 22.230(a), 101.255(a) and 200.317(a)).

enter into the transaction or contract on his or her behalf. The statute already picked up the concept of affiliates and associates to some degree by referencing organizations in which a managerial official is a managerial official or has a financial interest. The change makes clear that an affiliate or associate may obtain the safe harbor protections of these Sections, as implied in the prior provisions, to make certain the contract or transaction is not void or voidable by the entity because of the conflict of interest. Inclusion of contracts and transactions with all affiliates and associates should not be construed to infer that all such contracts or transactions are necessarily subject to attack if they do not meet the criteria in these revised provisions.

Subsection (b) in each Section is further amended to clarify that the contract or transaction is not void or voidable and is valid and enforceable notwithstanding the conflicting relationship or interest if the requirements of the Section are satisfied. The main objective of these Sections is to overcome the application of some old court cases, in the corporate law field, that allowed a corporation to treat as void or voidable any conflict of interest contract if was determined to be unfair to the corporation. The prior language of Subsection (b) spoke in terms of the contract or transaction being "valid". Implicit in that word is the concept that the contract or transaction is enforceable and not void or voidable. The revised language further clarifies this intent by using more of the terms that were used in such old court cases (i.e., "void or voidable").[15]

Finally, a new Subsection (e) is added to each of the Sections specifying that neither the domestic entity nor any of its owners have any cause of action against the conflicted managerial official for breach of duty in respect of the contract or transaction because of such relationship or interest or the taking of any actions described by Subsection (d) (i.e., the execution of a consent or the participation in the meeting of governing persons). While the prior language did not expressly address breaches of duty, there is implicit in those provisions the idea that the managerial officials are protected if they follow the statutory approval procedures authorized by these Sections. Many lawyers have assumed that compliance with the statutory approval procedure would preclude a breach of duty claim. This new language creating limited protection from breach of duty claims represents probably the most significant clarification of these Sections.[16]

4. Record Date for Meeting Adjournment

S.B. 748 clarifies that a record date for determining the owners or members of a domestic entity for purposes of a vote or other entity action must be a date that is not earlier than the 60th day before the date the action requiring the determination of owners or members is originally to

[15] S.B. 748 §§ 28, 33, 38 and 57 (to be codified at TBOC §§ 21.418(b), 22.230(b), 101.255(b) and 200.317(b)).

[16] S.B. 748 §§ 28, 33, 38 and 57 (to be codified at TBOC §§ 21.418(e), 22.230(e), 101.255(e) and 200.317(e)). The clarifying changes contained in new Subsection (e) are also intended, in part, by the drafting committee to respond to a comment made by Houston federal district court Judge Harmon in one of her opinions that the statute did not address liability of the director for damages and that a director could still be subject to a suit for damages even though the contract itself could not be avoided under the statute. *See Floyd v. Hefner,* 2006 WL 2844245, at fn 7.

be taken.[17] It is unclear, under the prior Code language, whether adjournments of a meeting to a date later than 60 days after the record date would require the setting of a new record date and, therefore, a new notice to the owners or members of the entity. As a result of the change, the same record date will apply to any adjournments of a meeting.

5. Indemnification Clarifications

S.B. 748 clarifies the Code's indemnification provisions to expressly name current, in addition to former, officers as persons who may be reimbursed reasonable expenses in advance of the final disposition of a proceeding and on terms the enterprise considers appropriate. That authority already exists in the current reference to a "present or former employee or agent," because an officer is an agent, but there is no reason not to expressly refer to a present officer. The changes also clarify that the present or former employee, agent or officer cannot also be a present governing person, because present governing persons are subject to the more stringent requirements in Code Section 8.104(a). Because of the new express reference to an officer, "managerial official," which includes an officer, is revised to read only "governing person."[18]

Section 8.151 is amended to add a new subsection (c-1) specifying that a vote of a majority in interest of the limited partners constitutes approval of the owners under subsection (c) of that Section with respect to a limited partnership.[19] This provision parallels similar provisions contained in Sections 8.103(d) and 8.104(d), except that the exclusion in those provisions for the interest of a general partner that is not disinterested and independent is unnecessary in relation to approval of any liability insurance, self-insurance arrangement or indemnity agreement. Because of the exclusion of such general partner's interest, Sections 8.103(d) and 8.104(d) are clarified by adding a definition of a "majority-in-interest" to mean, with respect to limited partners, limited partners owning more than 50% of the partnership profits owned by all of the limited partners.[20]

6. References in Governing Documents to Prior Statutes and Old Terminology

When the Code first became effective on January 1, 2006, the Code did not require any then existing Texas entities or any foreign entities then qualified or registered to transact business in Texas (collectively "*Pre-Code Entities*") to become subject to the Code or to amend their governing documents or their applications for foreign qualification, respectively, to comply with or conform to the Code. When the Code became universally applicable to most entities on January 1, 2010, and the Previous Statutes were generally repealed, the Code also did not require any then existing Texas entities or any foreign entities then qualified or registered to transact business in Texas to amend their governing documents or their applications for foreign qualification, respectively, to comply with or conform to the Code. To the contrary, Section 402.005 of the Code require a Pre-Code Entity that is of a type that would be a "filing entity" under the Code (e.g., a domestic corporation, limited partnership or limited liability company) to amend its certificate of formation to comply with or conform to the Code only when

[17] S.B. 748 § 2 (to be codified at TBOC § 6.101(b)).
[18] S.B. 748 § 7 (to be codified at TBOC § 8.105(d)).
[19] S.B. 748 § 34.
[20] S.B. 748 §§ 5, 6.

the Pre-Code Entity next files an amendment to its certificate of formation. The same section requires a foreign Pre-Code Entity to amend its application for foreign qualification to comply with or conform to the Code only when it next files an amendment to such application for foreign qualification.[21]

Since January 1, 2010, as Texas lawyers have been requested 2010, to render third-party opinions on transactions regarding Pre-Code Entities, questions have arisen regarding the ability of such lawyers to opine as to the existence of domestic Pre-Code Entities, the registration to transact business of foreign Pre-Code Entities, the good standing of Pre-Code Entities, and the power and authority of Pre-Code Entities. Questions also have arisen as to the construction of certain references in the governing documents of Pre-Code Entities to the Previous Statutes or particular provisions of Previous Statutes.

To address these issues, S.B. 748 adds new Section 402.0051 to clarify that references in a governing document on filing instrument (including a certificate of formation or application for registration) to prior law (including any Previous Statutes), use of synonymous terminology contained in prior law or inclusion of provisions authorized by prior law at the time of filing or adoption are not nonconforming and, therefore, not required by Section 402.005(a)(3) or (4) to be updated in an entity's next amendment.[22] These clarifications address practitioners' concerns of whether Section 402.005(a)(3) or (4) requires an amendment to a governing document or filing instrument to update references to prior law or replace prior terminology with Code terminology.

To further address the issues, S.B. 748 also adds a new subsection (c) to Section 402.005 of the Code. That subsection clarifies that a Pre-Code Entity is not considered to have failed to comply with the Code because of any of the following: (i) a certificate of formation's failure to state the type of entity formed; (ii) the failure, in an application for registration as a foreign entity or any amendment thereto, to state the type of entity or to appoint the Secretary of State of Texas as agent for service of process under the circumstances provided by Section 5.251 of the Code; or (iii) a circumstance described by Section 402.0051 applies.[23] Accordingly, none of such items or matters are required to be updated in the next amendment by a Pre-Code Entity to its certificate of formation or its application for registration, as applicable.

Finally, conforming clarifications have been made to the provisions relating to early adoption of the Code as the governing statute by Pre-Code Entities during the period between January 1, 2006 and January 1, 2010. These changes provide that a domestic or foreign Pre-Code Entity is not considered to have failed to cause its governing documents or application for registration, as applicable, to comply with the Code as required by the election process because the governing documents or application for registration do not state the entity's type, a circumstance described in new Section 402.0051 applies, or the application for registration fails

[21] TBOC § 402.005(a)(3) and (4).
[22] S.B. § 62.
[23] S.B. 748 § 61 (to be codified at TBOC § 402.005(c)).

to appoint the Texas Secretary of State as agent for service of process under the circumstance provided by Section 5.251.[24]

7. Reinstatement of Entities Under Code

On its face, Code Section 402.013 only applies to reinstatements of entities prior to January 1, 2010. The question has arisen as to whether provisions similar to Section 402.013 should apply after January 1, 2010 with respect to the reinstatement of entities whose certificate of formation or registration to do business has been canceled, revoked, suspended or forfeited under prior law. S.B. 748 rectifies this situation by adding provisions specifying that, on or after January 1, 2010, a domestic filing entity whose existence has been voluntarily dissolved or involuntarily dissolved under prior law or whose certificate of formation has been canceled, revoked, suspended or forfeited under prior law may reinstate the entity in accordance with the Code. Similarly, on or after January 1, 2010, a foreign filing entity whose registration to do business has been canceled, revoked, suspended or forfeited under prior law may reinstate its registration in accordance with the Code.[25] To reinforce the validity of any prior reinstatements of domestic filing entities that occurred prior to January 1, 2010 under the Code, S.B. 748 specifically validates such reinstatement of a domestic filing entity whose existence has been voluntarily dissolved under prior law or whose certificate of formation has been canceled under prior law.[26]

8. Definition of "Person"

S.B. 748 clarifies Section 1.002(69-B) by supplying a definition of "person" for the Code and deleting the existing cross-reference to the definition of that term in the Government Code.[27] Numerous practitioners had expressed frustration with the Code's failure to include a definition of "person" within its provisions, which caused such practitioners to have to look for the definition of that term in the Government Code.

B. Partnership and LLC Amendments

1. Limited Liability Partnerships

Prior to S.B. 748, Code Section 152.804 required limited liability partnerships, as a condition to their registration, to provide evidence of $100,000 of liability insurance or a $100,000 cash deposit, bank letter of credit or insurance company bond (referred to herein as the "*Insurance Requirement*"). As the first state to adopt a statute authorizing limited liability partnerships, the original draftsmen of the statute believed this additional Insurance Requirement was necessary from a political standpoint to enable passage of that original legislation, which provided liability protection for general partners. As time passed and other states adopted their own limited liability partnership statutes, the Insurance Requirement came to be recognized as unwieldy and unfair and was not adopted in most other states. Indeed, there are no similar

[24] S.B. 748 §§ 59, 60 (to be codified at TBOC §§ 402.003(b), 402.004(b)).
[25] S.B. 748 § 64 (to be codified at TBOC §§ 402.013(b-1), (b-2)).
[26] S.B. 748 § 65.
[27] S.B. 748 § 1.

Insurance Requirements in the Uniform Partnership Act (1997) or the current limited liability partnership statutes of most jurisdictions. It is impractical to impose a one-size-fits-all Insurance Requirement for limited liability partnerships because they vary widely in size and activities. The type and amount of liability insurance, cash deposit or bond that is appropriate will vary depending upon the nature of the business. The Code does not require any other type of business entity or professional entity (i.e., professional corporation, professional association or professional limited liability company) to satisfy a similar Insurance Requirements. The difficulties in interpreting and applying the Insurance Requirement under the Texas limited liability partnership provisions cause limited liability partnerships in Texas to suffer a disadvantage compared to limited liability partnerships formed in other states and other types of business entities formed in Texas. For the foregoing reasons, S.B. 748 contains a repeal of Section 152.804 and other provisions that cross-reference to such section or contain provisions relating to such Insurance Requirement.[28]

Prior to S.B. 748, Code Section 152.801 specified when a partner in a limited liability partnership is liable for an error, omission, negligence, incompetence, or malfeasance of another partner or representative of the partnership. S.B. 748 deletes these provisions, which specified that a partner could be liable if the partner (a) was supervising or directing the responsible partner or representative or was directly involved in the specific activity in which the error, omission, negligence, incompetence or malfeasance was committed or (b) had notice or knowledge of such error, omission, negligence, incompetence or malfeasance by the responsible partner or representative and failed to take reasonable action to prevent or cure the error, omission, negligence, incompetence or malfeasance.[29] As a result, these Code provisions more closely conform to the approach taken in the Uniform Partnership Act (1997) and the trend in other jurisdictions. The foregoing provisions are not found in the uniform law or the statutes of most other jurisdictions and are not considered necessary in view of the principle that a partner is usually liable for the partner's own tortious conduct.

In another clarifying change, S.B. 748 adds a provision specifying when an obligation is "incurred" with regard to limited liability partnership status to eliminate confusion created by the recent case *Evanston Ins. Co. v. Dillard Dept. Stores, Inc.*, 602 F.3d 610 (5th Cir. 2010). In that case, a limited liability partnership was formed in 2002 and ceased to exist as a registered limited liability partnership in Texas in July 2004. The court action was instituted in early 2004, while the limited liability partnership was still registered as such, when Dillard's Department Store sued the partnership for trademark infringement and various business torts. The court entered a final judgment against the partnership in November 2004 after its registration had expired. In 2008, Dillard's filed a third-party complaint against the two partners in the limited liability partnership seeking declarations that the two were personally liable for the final judgment against the partnership. The Fifth Circuit Court of Appeals held that the obligation was not incurred by the partnership until the judgment was entered in November 2004 notwithstanding that the conduct at issue occurred well before that date and during the time when the limited liability partnership was registered. S.B. 748 adds language that clarifies that an obligation is

[28] S.B. 748 § 66. Conforming amendments include the deletion of Section 152.802(i) by this same Section 66 of S.B. 748 and deletion of a cross-reference to Section 152.804 contained in Section 152.802(a). *Id*. at § 47.

[29] S.B. 748 § 46 (to be codified at TBOC § 152.801).

incurred while a partnership is a limited liability partnership if the obligation relates to an action or omission occurring while the partnership is a limited liability partnership or the obligation arises under a contract or commitment entered into while the partnership is a limited liability partnership.[30]

2. Charging Orders for General Partnerships

S.B. 748 adds charging-order provisions applicable to partnership interests in general partnerships that are similar to those contained in Code Section 153.256 for limited partnerships and in Section 101.112 for limited liability companies.[31] There does not appear to be any reason that the partnership interest in a general partnership should be treated differently than a limited partnership interest or a membership interest in a limited liability company. Prior to the adoption of the TRPA, Texas law governing general partnerships provided for charging orders. The provisions of the TRPA abandoned the charging order concept under the expectation that other states would follow suit and would allow a judgment creditor to have the usual panoply of remedies with respect to collection of its judgment against the partnership interests in a general partnership. However, the Uniform Partnership Act (1997) and the vast majority of other states have provisions relating to charging orders for a partnership interest in a general partnership. Under the new provisions added by S.B. 748 to the Code, a judgment creditor may obtain a charging order from a court having jurisdiction against the partnership interest of the judgment debtor to satisfy the judgment. The charging order constitutes a non-foreclosable lien on the partnership interest. The entry of the charging order is the exclusive remedy of the judgment creditor with respect to the partnership interest. The new provisions do not deprive a partner or other owner of a partnership interest of a right under exemption laws with respect to the judgment debtor's partnership interests. In addition, a creditor of a partner does not have the right to obtain possession of, or otherwise exercise legal or equitable remedies with respect to, the property of the partnership.[32]

3. Reasonable Restrictions on Access to LLC and Limited Partnership Records

S.B. 748 amends Section 101.054 to specify that a company agreement of a limited liability company may not unreasonably restrict the right of access of a member or manager to records and information.[33] By implication, reasonable restrictions on the access of a member or manager to records and information of the limited liability company are permitted by this new provision. Such a restriction might include a member's or manager's agreement to maintain the confidentiality of the information obtained through such access. The Code is much less flexible than the statutes of many other states, including Delaware, which allow the governing documents of a limited liability company to provide for different kinds of restrictions on the access of a member or manager to the company's records and information. This new statutory provision is consistent with Code Section 152.002(b)(1), which relates to general partnerships.

[30] S.B. 748 § 46 (to be codified at TBOC § 152.801(c)).
[31] S.B. 748 § 43 (to be codified at TBOC § 152.308).
[32] *Id*.
[33] S.B. 748 § 34 (to be codified at TBOC § 101.054(e)).

For limited partnerships, S.B. 748 makes a similar change to specify that a limited partnership agreement may not unreasonably restrict a partner's right to access to books and records under Section 153.552.[34] By implication, the limited partnership agreement may, therefore, reasonably restrict a partner's right of access to the limited partnership's books and records. Again, this provision is more consistent with the flexibility provided in statutes of other states, including Delaware, and results in a provision that is more consistent with Section 152.002(b)(1) for general partnerships.

4. Non-Waiver of Certain Series LLC Provisions

Senate Bill 1442 in the 2009 Texas Legislature added Subchapter M to Chapter 101 authorizing so-called "series limited liability companies." Section 101.054 specifies which provisions of Chapter 101 cannot be waived or modified in the company agreement. While adding Subchapter M, corresponding provisions were not made in 2009 to Section 101.054 to specify which series limited liability requirements could not be waived or modified by the company agreement. S.B. 748 amends Section 101.054 to provide that Sections 101.602(b) and 101.613 relating to series limited liability companies cannot be waived or modified in the company agreement.[35] Code Section 101.602(b) requires a series limited liability company to satisfy the following requirements in order for the debts, liabilities, obligations and expenses incurred, contracted for or otherwise existing with respect to a particular series to be enforceable against the assets of that series only and not against the assets of the limited liability company generally or any other series: (i) the records maintained for a particular series must account for the assets associated with that series separately from the other assets of the limited liability company or any other series; (ii) the company agreement must contain a statement to the effect of the limitations on liability provided by Section 101.602(a); and (iii) the company's certificate of formation must contain a notice of such debt limitations. Code Section 101.613 prohibits a limited liability company from making a distribution with respect to a series to a member of that series if, immediately after making the distribution, the total amount of the liabilities of the series, other than certain specified liabilities, exceeds the fair value of the assets associated with the series.

5. Membership Interests as Community Property

S.B. 748 clarifies how the ownership of a membership interest and a member's right to participate in the management and conduct of the business of the limited liability company are treated for community law purposes. Specifically, the amendment clarifies that a membership interest may be community property under applicable law and that a member's right to participate in the management and conduct of the business of the limited liability company is not community property.[36] The provisions are modeled after similar provisions applicable to partnerships contained in Code Sections 152.203(a) and 154.001(b). The new provisions explicitly state rules that were implicit in the statutory provisions defining and describing a membership interest, specifying the consequences of a transfer of a membership interest, and addressing admission of a member.

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[34] S.B. 748 § 51 (to be codified at TBOC § 153.304(a)).
[35] S.B. 748 § 34.
[36] S.B. 748 § 35 (to be codified at TBOC § 101.106(a-1), (a-2)).

6. Membership and Partnership Interests After Death or Divorce

S.B. 748 adds a new Section 101.1115 to clarify how a membership interest is treated on the divorce of a member or the death of a member or member's spouse. The provision explicitly states what is implicit in the statutory provisions (as further clarified by the amendment to Code Section 101.106 discussed above) defining and describing a membership interest, specifying the consequences of a transfer of a membership interest, and addressing admission of a member. Section 101.1115 is modeled after Code Section 152.406 governing partnership interests on the death or divorcee of a partner. The new Section makes clear that a non-member who, under other applicable law, succeeds to or retains an interest in a membership interest upon the death or divorce of a member acquires only the rights of an assignee of the membership interest.[37] In other words, member status and the appurtenant rights of the member to participate in the conduct and management of the business are not subject to devise or inheritance on the death of a member or the member's spouse or a division on divorce of a member.

S.B. 748 clarifies and modernizes in certain respects Section 152.406 governing partnership interests upon the divorce of a partner or the death of a partner or the partner's spouse. The phrase "if any" is added in several places to make clear that the divorce of a partner or death of a partner's spouse does not necessarily result in anyone other than the partner having a partnership interest. The more modern term "devisee" is substituted for "legatee," and the phrase "or other successor" is added to encompass non-testamentary transfers permitted under modern laws. Subsection (a)(2) is amended to make clear the interaction of the provision with the redemption provisions of Subchapter H of Chapter 152. The death of a partner is an event of withdrawal of the partner, and unless otherwise provided by the partnership agreement, the partnership interest of a withdrawn partner is automatically redeemed as of the date of withdrawal under Subchapter H of Chapter 152. Thus, unless the partnership agreement negates the automatic redemption of the partnership interest on the death of a partner, there are no transferees of the partnership interest, but merely successors of the deceased partner who are entitled to be paid the redemption price of the partnership interest. If the partnership agreement negates the automatic redemption of the partnership interest on the death of a partner, the successors of the deceased partner are transferees unless otherwise provided by the partnership agreement.[38]

7. Clarifications on Apparent Authority and Voting in LLCs

S.B. 748 clarifies Section 101.254(a) by deleting the reference "or agent" to eliminate the circularity of the existing provision. As revised, subsection (a) specifies that each governing person, and each officer of the limited liability company vested with actual or apparent authority by the company's governing authority, is an agent of the company for purposes of carrying out the company's business.[39]

[37] S.B. 748 § 36.
[38] S.B. 748 § 44 (to be codified at TBOC § 152.406(a), (c)).
[39] S.B. 748 § 37 (to be codified at TBOC § 101.254(a)).

S.B. 748 corrects Section 101.357(b) to move the phrase "if authorized by the accompanying agreement" from the preamble of subsection (b) to its proper position in clause (2).[40] As a result, it becomes clear that managers and committee members may vote in person, even if not specified by a company agreement, and that a company agreement may authorize managers or committee members of limited liability companies to act by written proxy.

8. Clarifications as to Partnership Obligations

S.B. 748 eliminates in several Code provisions the redundancy in the phrase "debt or obligation" by referring simply to an "obligation," which is the term used in the Uniform Partnership Act (1997) and which encompasses all types of debts and liabilities.[41] These changes also make the changed provisions consistent with other provisions of Chapter 152 where the word "obligation," rather than the phrase "debt or obligation," is used.

C. Corporation Amendments

1. Dissenter Appraisal Rights Procedural Amendments

S.B. 748 amends Code Section 10.356 to conform the notice and demand provisions more closely to their source provisions in the TBCA, and to correct and make uniform the time period for the dissenting owner's payment demand. If the action is submitted to a vote of the owners at a meeting, a notice from an owner to the domestic entity of which he is an owner stating the owner's intent to exercise dissenters' rights must be delivered to the entity's principal executive office before the meeting. As revised by S.B. 748, this pre-meeting notice must be addressed to the entity's president and secretary, state that the owner's right to dissent will be exercised if the action takes effect, and must provide an address to which notice of effectiveness of the action should be delivered or mailed by the entity. This notice was required by the TBCA, but was combined in the Code's provisions with a second required notice demanding payment of the fair value of the owner's ownership interests, which is only practical to give after the effectiveness of the entity action giving rise to dissenters' rights. S.B. 748 restores the separateness of the pre-meeting notice and the second required demand notice. The second required notice is redesignated, in accordance with historical and common practice, as a "demand" to differentiate it from the pre-meeting notice. The time periods for the demand are amended to reflect that the demand is made after, and not before, the entity action (such as a merger) has become effective; that the time periods begin when the entity action is effective, and not upon the owners' vote or consent regarding that action; and that the length of time is 20 days after the action was effective regardless of whether the owners acted at a meeting or by written consent. Other conforming amendments are made to clarify that both the pre-meeting notice and the written demand after the entity action takes effect are required for the dissenting owner to be entitled to exercise the owner's dissent and appraisal rights. In addition, a 20-day time limit after the written demand by the owner is established for the owner to submit to the responsible organization any certificates representing the owner's ownership interests.[42]

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[40] S.B. 748 §39 (to be codified at TBOC § 101.357(b)).
[41] S.B. 748 §§ 42, 46, 49 (to be codified at TBOC §§ 152.304(a), 152.801, 152.910(b)).
[42] S.B. 748 § 16 (to be codified at TBOC § 10.356).

Section 10.358 is amended to conform certain language to that of the source statute, the TBCA, and to change the time periods for action on a responsible organization's offer of fair value to a dissenting owner and for payment of fair value to the dissenting owner. The revised provisions establish a time limit on the dissenters' rights procedure before either party applies to a court for determination of fair value of the dissenting owner's interest. The dissenting owner may consider the responsible organization's offer of fair value for a period extending until 90 days after the date on which the entity action was effective. This 90-day period is shorter than the prior Code provisions, which specified an indefinite time extending for at least 60 days after the offer was made, but it is also longer than the period specified in the source provision of the TBCA. Another amendment requires that, if the dissenting owner accepts the responsible organization's offer or the owner and responsible organization otherwise agree on the fair value within 90 days after the action took effect, the responsible organization must pay the agreed amount of fair value within 120 days after the date on which the entity action was effective. This period shortens to as few as 30 days the existing 60-day period for payment to the dissenting owner.[43]

Section 10.355(c)(2) is also amended to refer to subsections (b)(1) and (b)(3) of Section 10.356. Those two amended subsections describe the pre-meeting notice and post-action demand required by an owner desiring to exercise dissenters' rights.[44]

2. Deletion of Outdated References to Nasdaq and NASD

S.B. 748 adds a new defined term of "national securities exchange," which cross-references to the provisions relating to registration as a national securities exchange under the Securities Exchange Act of 1934, as amended (the "*1934 Act*").[45] Code Section 10.354(b), which specifies that owners of certain publicly traded ownership interests cannot dissent from a plan of merger or conversion, is revised to remove references to the "Nasdaq Stock Market or a successor quotation system" as well as the reference to a "national market security on an interdealer quotation system by the National Association of Securities Dealers, Inc."[46] These references have become outdated. The Nasdaq interdealer quotation system was the primary interdealer quotation system sponsored by the National Association of Securities Dealers, Inc. (the "*NASD*"). In 2000, the Nasdaq system underwent a major recapitalization and became an independent entity from the NASD. The NASD was merged in 2007 with the enforcement arm of the New York Stock Exchange, NYSE Regulation, Inc., and renamed the Financial Industry Regulatory Authority, or "*FINRA*". The Nasdaq Stock Market has since registered as a national securities exchange under the 1934 Act, which is already included in the provisions of Section 10.354(b). In addition, the vague reference to "or a similar system" is eliminated because it is undefined and adds uncertainty to the provision.

For the same reasons, Section 21.109(a), which specifies when a shareholders agreement ceases to be effective upon a corporation becoming publicly traded, is also amended to eliminate the outmoded reference to "interdealer quotation system of a national securities association" and

[43] S.B. 748 § 17 (to be codified at TBOC § 10.358).
[44] S.B. 748 § 15 (to be codified at TBOC § 10.355).
[45] S.B. 748 § 1 (to be codified at TBOC § 1.002).
[46] S.B. 748 § 14.

the vague reference to "or similar system."[47] Section 21.601(1)(c) is amended to refer to the new defined term "national securities exchange" in lieu of the current undefined term "national market system."[48]

3. Deletion of Outdated Transition Reference

S.B. 748 deletes unnecessary Section 21.001, which contained provisions specifying the applicability of Chapter 21.[49] Similar provisions are not contained in other Chapters of the Code relating to other types of entities. This section became confusing after the expiration of the Code's transition period between January 1, 2006 and January 1, 2010 and the repeal of the Previous Statutes as of January 1, 2010.

4. Clarifications of Application of Preemptive Rights and Shareholders Agreements Provisions

S.B. 748 adds new Section 21.110 to clarify that Subchapter C of Chapter 21, which relates to certain types of shareholders agreements for for-profit corporations, is not intended to prohibit or impair any other types of agreements between two or more shareholders or between a for-profit corporation and one or more of its shareholders that are permitted by other laws.[50] In other words, Subchapter C only applies to the type of shareholders agreements described in Section 21.101.

S.B. 748 also clarifies that Sections 21.203 through 21.208, which authorize statutory preemptive rights for shareholders of for-profit corporations, do not impair or invalidate a for-profit corporation's right or power to grant an enforceable non-statutory preemptive right in a contract between the corporation and a shareholder or other person or in the governing documents of the corporation.[51] The prior provisions could have been misconstrued to impair such right or power of the corporation.

S.B. 748 also amends Section 21.206(a) to specify that the statute of limitations created by that section only applies to violations of a preemptive right of a shareholder under Sections 21.203 and 21.204.[52] As a result, the statute of limitations applicable to a violation of a nonstatutory preemptive right of a shareholder arising under a contract with a corporation or a governing document of the corporation would be subject to the general residual statute of limitations for breaches of contract contained in Section 16.051 of the Texas Civil Practice and Remedies Code.

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[47] S.B. 748 § 21.
[48] S.B. 748 § 30. Section 21.601(1) contains the definition of "issuing public corporation" for the purpose of the subchapter of Chapter 21 governing business combinations with affiliated shareholders of for-profit corporations.
[49] S.B. 748 § 66.
[50] S.B. 748 § 22.
[51] S.B. 748 § 23 (to be codified at TBOC § 21.203(c)).
[52] S.B. 748 § 24.

5. Correction of Corporate Record Date Provision

S.B. 748 amends Section 21.357 to conform with the source law contained in TBCA Article 2.26.B, which required a record date for a meeting of shareholders of a for-profit corporation to be at least ten days before the date of the meeting.[53] This source provision was inadvertently expanded by Section 21.357 to cover any "actions" requiring the determination of shareholders. The ten-day minimum time period should only apply to meetings of shareholders of a for-profit corporation and not other actions, such as determining shareholders for purposes of dividends or sending notices of other types of actions. As revised, this section only applies to record dates for the purpose of determining shareholders entitled to notice or to vote at any meeting of shareholders or any adjournment of the meeting.

6. Clarification of Board of Directors Quorum

S.B. 748 clarifies Section 21.415(a) to expressly indicate that a quorum of directors must be present at a meeting of the board of directors of a for-profit corporation at the time of the act of a majority of the directors present at the meeting.[54] That result was implicit in the prior provision but is made more clear by the change.

7. Business Combinations with Affiliated Shareholders

S.B. 748 clarifies that the concept of "beneficial owner," as described in Section 21.603, applies only to Subchapter M of Chapter 21 relating to business combination transactions with affiliated shareholders.[55] The prior language purported to apply that concept to the entire Chapter 21, which is a departure from the source provisions in the TBCA. The broad concept of "beneficial owner" in Section 21.603 does not fit well in many of the other contexts in which that phrase or similar words are used in other parts of Chapter 21.

S.B. 748 also makes other changes to Section 21.603. The confusing reference to "similar securities" has been revised to refer to "other securities" throughout the text of the Section. As a result of that change, it is clear that convertible or exchangeable debt securities could result in the application of the provisions of Subchapter M. Another change clarifies a reporting of the agreement, arrangement or understanding on Schedule 13D under the 1934 Act is not required because such reporting requirements would not apply to private companies that might otherwise be subject to the provisions of Subchapter M. Other changes simplify the language, combine subsections and eliminate unnecessary cross-references.[56]

8. Close Corporation Clarification

S.B. 748 clarifies that a "close corporation" can include a corporation that becomes governed by Subchapter O as a close corporation as a result of Section 21.705, 21.706 or 21.707.[57] This result was implicit in the prior provisions, but a literal reading of the prior

[53] S.B. 748 § 26.
[54] S.B. 748 § 27.
[55] S.B. 748 § 31 (to be codified at TBOC § 21.603(a)).
[56] *Id*. (to be codified at TBOC § 21.603(a))
[57] S.B. 748 § 32 (to be codified at TBOC § 21.701(i)).

language specifying that a "close corporation" meant a domestic corporation formed under Subchapter O caused an ambiguity that is eliminated by S.B. 748.

III. S.B. 1568 - Shareholder Standing for Derivative Actions

A "derivative action" is an action brought in the right of a corporation by a shareholder against directors or officers for breach of fiduciary duty. To bring a derivative action, Section 21.552(a) of the Code requires that a person must have been a shareholder at the relevant times and must fairly represent the interest of the corporation in the action. In apparent conflict with this requirement, Section 21.552(b) of the Code stated that Chapter 10 or Subchapter J of Chapter 21 may not be construed to limit or terminate a shareholder's standing after a merger to the extent that the shareholder had standing immediately before the merger. This provision has caused confusion in the Texas legal community about whether a shareholder has standing to institute or maintain a derivative proceeding after a corporation's shares are converted into cash or securities of another entity pursuant to a merger.

Case law in Texas and elsewhere requires that the derivative plaintiff must be a shareholder both at the time of the action complained of and at the time of judgment. In *Somers v. Crane*, 295 S.W.3d 5, 13 (Tex. App.—Houston [1st Dist.] Mar. 26, 2009), a Texas appellate court clarified that "a shareholder must own stock at the time of filing a derivative suit and continuously through the completion of the suit to have derivative standing." S.B 1568 deletes Section 21.552(b), thereby eliminating this ambiguity and aligning the Code with the current state of the law on derivative proceedings.[58]

IV. S.B. 323 - LLC Liability Shield

Section 101.114 of the Code provides that a member or manager is not liable for the debts, obligations or liabilities of a limited liability company, except as and to the extent the company agreement or regulations specifically provide otherwise. On its face, this language prohibits a court from holding the members or managers liable for the debts, obligations and liabilities of the limited liability company. However, recent court cases have applied corporate veil piercing principles to limited liability companies, causing confusion as to the proper standards to be applied. Several court cases in Texas have determined, without a great deal of analysis, that corporate veil piercing standards should apply in the context of limited liability companies to overcome the statutory liability shield. *See, e.g., McCarthy v. Wani Venture, A.S.*, 251 S.W.3d 573, (Tex. App. - Houston [1st Dist.] 2007, pet. denied); *In re JNS Aviation, LLC (Nick Corp. v. JNS Aviation, Inc.)*, 376 B.R. 500 (Bankr. N.D. Tex. 2007). When applying corporate veil piercing standards to limited liability companies, these courts have generally recognized that the provisions of Texas Business Corporation Act Article 2.21, which are carried over in Sections 21.223 through 21.226 of the Code, were controlling with respect to such standards. For an excellent discussion of most of the Texas court cases addressing, and other relevant background information concerning, the topic of piercing the LLC veil, one should refer

[58] S.B. 1568 § 1.

to Professor Elizabeth Miller's excellent recent CLE paper titled "*Owner Liability Protection and Piercing the Veil of Texas Business Entities*."[59]

S.B. 323 clarifies the standards for the piercing of the liability shield for limited liability companies by adopting the standards set forth in the for-profit corporation statutory provisions. This approach is consistent with the result of the state and federal court cases in Texas that have addressed the issue to date. S.B 323 adds a new Section 101.002 to the Code which provides that Sections 21.223, 21.224, 21.225 and 21.226 apply to a limited liability company and its members, owners, assignees and subscribers, subject to the limitations contained in Section 101.114.[60]

V. S.B. 582 - Service of Process on LLCs by Political Subdivisions

S.B. 582 amends the Code and the Texas Civil Practices and Remedies Code in relation to service of process by political subdivisions. Code Section 5.257 is amended to add limited liability companies to special provisions specifying how service of process by a political subdivision can be effected against a corporation.[61] As a result, service of process by a political subdivision can be made against a limited liability company in a manner similar to service of process against a corporation.

VI. H.B. 2047 - Service of Process on Employees of Registered Agents That Are Organizations

The Code provides that a corporation may be personally served with process, notice or demand by service on its president and each vice president as an agent of the corporation.[62] In addition, a corporation can be served with process, notice or demand by service on its registered agent at the registered office in the State of Texas.[63] In many cases, the registered agent itself is a separate corporation. Issues have arisen in litigation as to whether service of process against the registered agent that is a separate corporation must be effected in the same manner as required by the foregoing provisions. Some courts have held that the corporate registered agent was not properly served under the circumstances of that case. H.B. 2047 clarifies the foregoing confusion arising from the circularity by providing that any employee of an organization that is serving as a registered agent may receive service of process, notice or demand at the registered office. The registered agent that is an organization must have an employee available at the registered office during normal business hours to receive such service.[64]

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[59] Presented at *Choice and Acquisition of Entities in Texas* conference sponsored by the State Bar of Texas CLE on May 27, 2011 in San Antonio, Texas.
[60] S.B. 323 § 1 (to be codified at TBOC § 101.002).
[61] S.B. 582 § 1 (to be codified at TBOC § 5.257).
[62] TBOC § 5.255(1).
[63] TBOC § 5.201.
[64] H.B. 2047 § 1 (to be codified at TBOC § 5.201(d)).

VII. H.B. 2098 - Joint Ownership of Domestic Entities by Physicians and Physician Assistants.

According to the Bill Analysis for H.B. 2098, certain sources have asserted that business partnerships between physicians and physician assistants would provide positive benefits to their patients, the community and a solution to the shortage of physicians and physician assistants in rural and other underserved areas. H.B. 2098 amends the Code to add new Section 22.0561 that authorizes properly licensed physicians and physician assistants to form a nonprofit corporation, a general partnership, a professional association or a professional limited liability company to perform professional services that fall within the scope of practice of those practitioners. For a nonprofit corporation, its purpose must consist of conducting medical, public health, sociology or related research in the public interest, supporting medical education through grants or scholarships, developing the capabilities of individuals or institutions studying, teaching or practicing medicine or acting as a physician assistant, or delivering health care or health education to the general public.[65] The other types of authorized entities have no such purpose restriction. For any of the foregoing authorized types of entities, a physician assistant may not be an officer of the entity and may not contract with or employ a physician to be a supervising physician of the physician assistant or of any physician in the entity. An organizer of the entity must be a physician and ensure that a physician or physicians control and manage the entity. A physician assistant or group of physician assistants may only have a minority ownership in the entity that does not equal or exceed the ownership interest of any individual physician owner. The authority and regulation of the practitioners is limited to their scopes of practice and respective licensing boards. The physician assistant may not interfere with the practice of medicine by a physician owner or the supervision of physician assistants by a physician owner.[66]

VIII. House Bill 2991 - Choice of Law for Qualified Transactions

A. General Background

H.B. 2991 makes certain amendments to Section 271.004 of the TBCC. In 1993, Section 35.51, which has been relocated in Chapter 271, was added to the TBCC to govern choice of law provisions in qualified transactions.[67] Under this provision, with certain exceptions, the parties to a "qualified transaction" may agree in writing that the law of a particular jurisdiction governs a particular issue relating to the transaction, including the validity

[65] H.B. 2098 § 1 (to be codified at TBOC § 22.0561(a)).

[66] H.B. 2098 §§ 1, 2, 3 (to be codified at TBOC §§ 22.0561(b)-(g), 152.0551 and 301.012(a-1) through (a-7)).

[67] *See* TBCC §§ 271.001-271.011. Prior to 1993, Texas relied on two primary principles for determining the enforceability of a choice of law provision in a contract that would otherwise constitute a qualified transaction. One provision of the Uniform Commercial Code (the "*UCC*") governed transactions subject to the UCC and required a "reasonable relationship" between the parties and the chosen jurisdiction to exist for that jurisdiction's laws to be applied to the transaction. Most remaining transactions were governed by the common law. In applying the common law, some courts relied on the Restatement (Second) of Conflict of Laws, Section 187, which provides that, with certain exceptions, a contractual choice of law will be enforced unless there is no reasonable basis for the choice.

or the enforceability of an agreement relating to the transaction or a provision of the agreement.[68] A "qualified transaction" means a transaction under which a party pays or receives, or is obligated to pay or is entitled to receive, consideration with an aggregate value of at least $1 million, or lends, advances, borrows or receives, or is obligated to lend or advance or is entitled to borrow or receive, money or credit with an aggregate value of at least $1 million.[69]

The law of a particular jurisdiction governs a particular issue relating to a qualified transaction if the transaction bears a reasonable relation to the chosen jurisdiction and if the parties to the transaction agree in writing that such law governs the issue.[70] The law of the particular jurisdiction governs the issue regardless of whether the application of that law is contrary to a fundamental or public policy of the State of Texas or of any other jurisdiction.[71] TBCC Section 271.004 provides that if the transaction, its subject matter or a party to the transaction is reasonably related to a particular jurisdiction, the transaction bears a reasonable relation to the transaction.[72] The same section contains specific alternative criteria to determine if a qualified transaction bears a reasonable relation to a particular jurisdiction.[73] Prior to H.B. 2991, these provisions specified that a transaction bears a reasonable relation to a jurisdiction if:

- a party to the transaction is a resident of the jurisdiction;
- a party to the transaction has a place of business in the jurisdiction, or if the party has more than one place of business, its chief executive office or an office from which the party conducts a substantial part of the negotiations relating to the transaction is in the jurisdiction;
- all or part of the transaction's subject matter is located in the jurisdiction;
- a party to the transaction is required to perform a substantial part of its obligations relating to the transaction in the jurisdiction, such as delivering payments; or
- a substantial part of the negotiations relating to the transaction occurred in the jurisdiction, and an agreement relating to the transaction was signed by a party to the transaction in the jurisdiction.

The nature of legal practice has changed significantly since 1993. Because of the advent of the Internet, there are much fewer "in person" closings and negotiations. Negotiations are typically handled long distance via telephone conferences, electronic messaging and the exchange of contracts via electronic means. Closings are handled through the exchange of copies of signed documents and signature pages via electronic means. In addition, while, in 1993, banks and financial institutions were more regional in nature, today there are many national and international banks that provide credit and financing across the United States in a variety of different kinds of transactions. H.B. 2991 is, in part, an attempt to update the statutory choice of law provisions for qualified transactions to reflect these developments since 1993.

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[68] TBCC § 271.005(a).
[69] TBCC § 271.001.
[70] TBCC § 271.005(a).
[71] TBCC § 271.005(b).
[72] TBCC § 271.004(a).
[73] TBCC § 271.004(b).

B. Alternative Criteria for Reasonable Relation Test

Criteria List Not Exclusive. H.B. 2991 clarifies that the list of alternative criteria to satisfy the "reasonable relation" test is not exclusive.[74] The prior language could have been read to imply that the list of criteria was exhaustive of all factors that should be considered in determining whether the test was satisfied.

Negotiations "From" Jurisdiction. The particular criteria relating to whether a substantial part of the negotiations relating to the qualified transaction occurred "in" the jurisdiction has been expanded to specify that the negotiations may also take place "from" the jurisdiction.[75] As a resut, lawyers and parties who are negotiating over the telephone from one jurisdiction with parties or lawyers located in another jurisdiction can choose the governing law of either jurisdiction to govern the qualified transaction.

Multi-Bank Large Loan Transactions. H.B. 2991 adds two new alternative criteria that can be used to satisfy the "reasonable relation" test. First, a transaction in which (i) all or part of the subject matter is a loan or other extension of credit in which a party lends, borrows, advances or receives, or is obligated to lend or advance or is entitled to borrow or receive, money or credit with an aggregate value of at least $25 million, (ii) at least three financial institutions or other lenders or providers of credit are parties to the transaction, and (iii) a party to the transaction has more than one place of business and has an office in the chosen jurisdiction, so long as the chosen jurisdiction is in the United States.[76] As a result, the parties to a multi-bank, syndicated loan transaction exceeding $25 million could choose as the governing law the laws of the State of New York if one of the banks has an office located in that state. This change reflects the practice for most large syndicated multi-bank loan transactions where New York law tends to be the governing law preferred by national and international banks.

Transactions Relating to Entity's State of Formation. H.B. 2991 adds a second new criteria permitting the choice of a particular jurisdiction if all or part of the subject matter of the transaction is related to the governing documents or internal affairs of an entity formed under the laws of the chosen jurisdiction. The new statutory provision specifically includes in the criteria an agreement among members or owners of the entity, an agreement or option to acquire a membership or ownership interest in the entity, the conversion of debt or other securities into an ownership interest in the entity, or any other matter relating to rights or obligations with respect to the entity's membership or ownership interests.[77] For example, the parties to a qualified transaction involving the capitalization or funding of a private investment fund entity can elect that the transaction be governed by Delaware law if the entity is formed in Delaware. In today's times, many private equity fund entities are formed in Delaware. This new criteria eliminates any ambiguity under Texas law as to whether the parties can choose the law of the state of formation of the private equity entity to govern the agreement relating to the qualified transaction.

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[74] H.B. 2911 § 1 (to be codified at TBCC § 271.004(b)). The revised text replaces "if" with "includes" in the preamble to subsection (b).
[75] *Id*. (to be codified at TBCC § 271.004(b)(1)(E)).
[76] *Id*. (to be codified at TBCC § 271.004(b)(2)).
[77] *Id*. (to be codified at TBCC § 271.004(b)(1)(F)).

C. Changes in Parties or Documents

H.B. 2991 also attempts to cure issues that may have arisen as a result of a change in parties or an amendment of the applicable documents related to a qualified transaction. Prior law was unclear if a promissory note was sold from a party in one jurisdiction to another holder in a different jurisdiction whether the note would continue to bear a reasonable relation to the original jurisdiction. Likewise, if a holder of a promissory note moved to another jurisdiction, an issue would arise as to whether the original choice of law would continue to be enforceable under the transaction. H.B. 2991 makes clear that a reasonable relation established at the inception of the qualified transaction is preserved despite subsequent changes in the transaction, the subject matter of the transaction or the parties to the transaction or despite amendments to any agreement relating to the transaction.[78]

IX. Senate Bill 782 - Amendments to UCC Chapter 9 Secured Transactions

A. General

S.B. 782 enacts changes to Chapter 9 Secured Transactions of the TBCC. Most of the changes represent uniform changes to the UCC approved by the National Conference of Commissioners of Uniform State Laws ("*NCCUSL*") and the American Law Institute ("*ALI*"). The changes will have a delayed effective date of July 1, 2013 to allow additional time for education of interested parties and the possibility of additional changes in the 2013 Texas Legislature if other related uniform amendments to Chapter 9 are approved by NCCUSL and the ALI or if further clarifying amendments are determined to be advisable by Texas practitioners.

B. Changes in Definitions

S.B. 782 makes several changes to the definitions contained in TBCC Section 9.102. In the definition of "authenticate", S.B. 782 removed the confusing reference to "to execute or otherwise adopt a symbol" and revises the language to read more clearly "to attach to or logically associate with the record and electronic sound, symbol or process."[79] This definition serves the same function for electronic records in the context of Chapter 9 as a signature on a writing.

The definition of "certificate of title" is revised to allow a security interest relating to a certificate of title, if permitted by the applicable statute, to be indicated on an alternative record maintained by the governmental unit that issues the certificate of title.[80] Thus, the security interest does not always have to be reflected on the actual certificate of title but may be indicated on records maintained by the governmental unit under appropriate circumstances.

S.B. 782 adds a new definition of "public organic record" to mean a record that is available for inspection by the public and that is: (a) the initinial record filed with or issued by a state or the United States to form an organization and any record filed with or issued by the state or the United States that amends or restates the initial record, (b) the initial organic record of a business trust required to be filed with a state by the statute governing business trusts in that state

[78] *Id*. (to be codified at TBCC § 271.004(c)).
[79] S.B. 782 § 1 (to be codified at TBCC § 9.102(7)).
[80] *Id*. (to be codified at TBCC § 9.102(10)).

and any record filed with the state that amends or restates the initial record, or (c) legislation that forms or organizes an organization, any record amending the legislation and any record filed with or issued by the state or the United States that amends or restates the name of the definition of the organization.[81]

The new defined phrase "public organic record" has been added to a revised definition of "registered organization." The revised definition requires the filing of a public organic record with or the issuance of a public organic record by, or the enactment of legislation by, a single state or the United States to form or organize the organization. A business trust is only included in the definition of "registered organization" if it is formed or organized under the laws of a single state if that state's statute governing business trusts requires the business trust's organic record to be filed with the state.[82]

C. Electronic Chattel Paper Control Systems

S.B. 782 amends the standards for control of electronic chattel paper by allowing such control to be established through a system employed for evidencing the transfer of interests in the chattel paper. The system must reliably establish the secured party as the person to which the chattel paper was assigned. Otherwise, the system must satisfy the other standards for control of electronic chattel paper.[83]

D. Designation of Location by U.S. Registered Organizations

S.B. 782 clarifies that a registered organization (or a branch or agency of a bank) that is organized under the law of the United States may designate its state of location by designating its main office, home office or other comparable office if the United States law authorizes the registered organization (or bank branch or agency) to designate a state of location.[84]

E. Certificate of Title Statutes

TBCC Chapter 9 provides that the filing of a financing statement is not necessary or effective to perfect the security interest in property that is subject to a certificate of title statute. The prior provisions specifically listed a number of Texas statutes under which certificates of title were issued. S.B. 782 removes the listing of specific statutes and replaces it with generic language that specifies that the financing statement is not necessary or effective if the property is subject to a Texas certificate of title statute (or rules adopted under the statute) to the extent the statute (or rules) provides for a security interest to be indicated on the certificate of title as a condition or result of perfection, or such alternative to notation as may be prescribed by such statute (or rules).[85]

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[81] *Id*. (to be codified at TBCC § 9.102(68-a)).
[82] *Id*. (to be codified at TBCC § 9.102(71)).
[83] S.B. 782 § 2 (to be codified at TBCC § 9.105).
[84] S.B. 782 § 3 (to be codified at TBCC § 9.307(f)).
[85] S.B. 782 § 4 (to be codified at TBCC § 9.311(a)(2)).

F. Perfection Upon Changes in Debtor's Location

S.B. 782 adds new provisions that specify the perfection rules relating to collateral to which a security interest attaches within four months after the debtor changes its location to another jurisdiction. A financing statement filed before the change of debtor's location remains effective to perfect the security interest in the new collateral if it would have been effective to perfect a security interest in the collateral before the change in location. However, the security interest becomes unperfected if the security interest does not become perfected under the law of the new jurisdiction before the earlier of the expiration of the four-month period or the time the financing statement would have become ineffective under the law of the original jurisdiction, and it is deemed never to have been perfected as against a purchaser of the collateral for value.[86]

G. Perfection Upon New Debtor in Different Location

S.B. 782 also adds new provisions that specify the perfection rules relating to a financing statement that has been filed against an original debtor in one jurisdiction as it relates to a new debtor located in another jurisdiction. The financing statement remains effective to perfect a security interest in collateral in which the new debtor has or acquires rights before or within four months after the new debtor becomes bound under Section 9.203(d), if the financing statement would have been effective to perfect a security interest in the collateral if the collateral had been acquired by the original debtor. If the security interest becomes perfected under the law of the jurisdiction of the new debtor before the earlier of the expiration of the four-month period or the time the financing statement would have become ineffective under the law of the original jurisdiction, it remains perfected thereafter. If the security interest does not become perfected under the law of the new debtor's jurisdiction, it becomes unperfected and is deemed never to have been perfected as against a purchaser of the collateral for value.[87] S.B. 782 also makes a conforming change to Section 9.326 to add a cross reference to this new perfection provision and to clarify the subordination of the security interest created by the new debtor in collateral in which the new debtor has or acquires rights by virtue of such new provisions, as well as existing Section 9.508.[88]

H. Assignment of Texas Lottery Prize

S.B. 782 adds a new subsection (k) to TBCC Section 9.406 providing that an assignment under Section 9.406 is subject to Section 466.410 of the Government Code, which requires an order of the Travis County district court in order to effect an assignment of a Texas lottery prize that is payable in installments. However, to the extent that the assignment of installment prize payments due within the final two years of the prize payment schedule is prohibited by Section 466.410(a) of the Government Code, Section 9.406 will prevail solely to the extent necessary to permit an assignment under Section 9.406.[89]

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[86] S.B. 782 § 6 (to be codified at TBCC § 9.316(h)).
[87] *Id*. (to be codified at TBCC § 9.316(i)).
[88] S.B. 782 § 8 (to be codified at TBCC § 9.326(a)).
[89] S.B. 782 § 9 (to be codified at TBCC § 9.406(k)).

I. Name of Debtor in Mortgage

S.B. 782 clarifies that a mortgage is sufficient as a fixture financing statement with respect to an individual debtor if it provides the individual name of the debtor or the surname and first personal name of the debtor notwithstanding that the name differs from the name on the Texas driver's license or personal identification card issued to the individual debtor.[90]

J. Name of Debtor in Financing Statement

S.B. 782 clarifies and makes more precise the provisions contained in TBCC Section 9.503 for stating the name of the debtor on a UCC financing statement. For a registered organization, the name on the financing statement must be the registered organization's name on the public organic record most recently filed with or issued or enacted by the registered organization's jurisdiction of organization that purports to state, amend or restate the registered organization's name.[91] If the collateral is being administered by the personal representative of a decedent, the financing statement must provide the name of the decedent and, in a separate part of the financing statement, indicate that the collateral is being administered by a personal representative.[92] If the collateral is held in a trust that is not a registered organization, the financing statement must state as the name of the debtor the name of the trust if the organic record for the trust specifies a name for the trust. If the organic record of the trust does not specify a name for the trust, the name of the settlor or testator must be provided. In either case, in a separate part of the financing statement, a statement must indicate that the collateral is held in a trust. Where the organic record does not specify a name for the trust, the financing statement must also provide additional information sufficient to distinguish the trust from other trusts having one or more of the same settlors or the same testator.[93]

For individual debtors, the financing statement must state as the name of the debtor the name that is indicated on the individual's latest unexpired Texas driver's license or personal identification card. If the individual has no unexpired Texas driver's license or personal identification card, the financing statement must provide the individual name of the debtor or the surname and first personal name of the debtor.[94]

K. Transition Provisions

S.B. 782 adds new Subchapter H to Chapter 9 containing lengthy transition provisions with respect to the amendments enacted by S.B. 782.[95] A summary of these transition provisions is beyond the scope of this paper. Anyone who represents secured parties in connection with the preparation and filing of financing statements should review the transition provisions to determine how they may impact those activities prior to July 1, 2013.

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[90] S.B. 782 § 11 (to be codified at TBCC § 9.502(c)(3)).
[91] S.B. 782 § 12 (to be codified at TBCC § 9.503(a)(1)).
[92] *Id*. (to be codified at TBCC § 9.503(a)(2)).
[93] *Id*. (to be codified at TBCC § 9.503(a)(3)).
[94] *Id*. (to be codified at TBCC § 9.503(a)(4), (5)).
[95] S.B. 782 § 18 (to be codified at TBCC §§ 9.801 – 9.809).