FRAUDULENT TRANSFERS
AND PIERCING THE CORPORATE VEIL

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I. INTRODUCTION

This article discusses remedies available to creditors to avoid transfers of assets in fraud of the rights of creditors, piercing the corporate veil and similar theories of law.

II. DO NOT DO IT WITHOUT GOOD REASON

As a general rule, it is not advisable to pursue remote assets and remote parties in ordinary collection cases. The creditor made a decision to extend credit to a particular individual, partnership or corporation, and that is who you should sue. If the creditor did not request a written security agreement and retain a security interest in the goods it sold, then, in the ordinary case, you should not try to pursue the goods or proceeds into the hands of a third party. If the creditor did not request the written guaranty of a corporation's president before extending credit, then, in the ordinary case, you should not seek to find some other theory of law to impose personal liability upon him for the corporation's debt.

It takes two things to make a claim collectible through suit: good liability and a solvent debtor. If the debtor to whom credit was extended is out of business or is insolvent, there is often a temptation to try to impose liability upon somebody else. As a general rule, don't do it. If your client made a bad credit decision, that is his fault. If you undertake to bring suit against a remote party and do not succeed, your client will perceive it to be your fault.

Do not attempt to pursue a remote party or remote assets unless you have the evidence in hand before you file the suit. Don't expect to be able to develop the evidence in pretrial discovery.

III. TRANSFERS THAT ARE IN FRAUD OF CREDITORS

Three types of fraudulent transfers may be attacked:

1. A transfer made with actual intent to hinder, delay or defraud creditors,
2. A transfer made while insolvent, without receiving reasonably equivalent value, and
3. A transfer made while insolvent to an insider.


IV. “CLAIMS” ARE DEFINED BROADLY

The Act defines the term “claim” very broadly. “Claim” means a right to payment or property, whether or not the right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured. Tex. Bus. & Comm. Code § 24.002(12).

The claimant need not be a creditor whose rights are grounded in contract. Tort claimants are entitled to file causes of action under the Uniform Fraudulent Transfer Act based upon pending unliquidated tort claims. Redmond v. Griffith, 202 S.W.3d 225, 241 (Tex. App.—Tyler 2006, no writ). In that case, the minority shareholders in a closely held corporation sued the majority shareholders for breach of fiduciary duty and sought to avoid transfers which the majority shareholders made of their personal assets.

However, in practice, it is difficult to maintain a suit to avoid a fraudulent transfer unless the creditor has reduced his claim to judgment. Otherwise, you have to try the merits of the creditor’s claim as part of the fraudulent transfer suit. If you join a suit to avoid a fraudulent transfer with the suit on the underlying debt, you may inspire the debtor to mount a vigorous defense to the merits of the debt, which would otherwise go by default.

“Claims” cannot be stacked and “claim” means a claim against the debtor. A suit to set aside a transfer cannot be brought by creditors of creditors of the debtor. Nobles v. Marcus, 533 S.W.2d 923, 927 (Tex. 1976).
If a debtor files for bankruptcy, he admits that he is insolvent and has creditors who hold valid claims. The trustee has standing to bring suit to avoid fraudulent transfers as the representative of the creditors. 11 U.S.C. § 544. Avoidance of fraudulent transfers by a bankruptcy trustee is discussed later in this article.

V. “TRANSFERS” ARE DEFINED BROADLY

The Act also defines transfers broadly. “‘Transfer’ means every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with an asset or an interest in an asset, and includes payment of money, release, lease, and creation of a lien or other encumbrance.” Tex. Bus. & Comm. Code § 24.002(12).

Certain types of transfers are excluded. Termination of a lease upon default by the debtor is not a transfer in fraud of creditors. § 24.009(e)(1). Enforcement of a security interest in compliance with Article 9 of the UCC is not a transfer in fraud of creditors. § 24.009(e)(2).

Disclaimer of an inheritance under Section 37A of the Texas Probate Code, or Section 112.01 of the Property Code cannot be set aside as a transfer in fraud of creditors. Dyer v. Eckols, 808 S.W.2d 531, 534-535 (Tex. App.–Houston [14th Dist.] 1991, writ dism’d by agr.).

VI. “ASSET” MEANS THE DEBTOR’S INTEREST IN NONEXEMPT PROPERTY

The term “Asset” is defined by the statute to mean only the debtor’s equity in property, which is subject to a lien, and not the entire value of the property. Tex. Bus. & Comm. Code § 24.002(2)(A) provides that the term “Asset” does not include property to the extent it is encumbered by a valid lien. Therefore, if the asset transferred is encumbered by a valid lien for an amount which is equal to or greater than the value of the property, the transfer may not be avoided under the act.

The term “Asset” is defined to exclude property which is exempt from the claims of general creditors. Tex. Bus. & Comm. Code § 24.002(2)(B) provides that “Asset” does not include property to the extent it is generally exempt under non-bankruptcy law. Therefore, transfer of the debtor’s homestead cannot be attacked as a transfer in fraud of creditors. Likewise, a transfer of personal property which is exempt under Texas Property Code § 42.001 cannot be set aside as a transfer in fraud of creditors.

Only the debtor’s equity in nonexempt assets is counted for purposes of determining whether or not the debtor was insolvent at the time the transfer was made. The value of exempt assets is not counted in determining whether the debtor was insolvent.

A remainder interest in real property is an asset which may be the subject of a transfer in fraud of creditors. In the case of In re Porras, 312 B.R. 81 (Bankr.W.D.Tex. 2004), the grandfather’s will left a tract of real property to the debtor’s mother for life, and a remainder to the debtor, but only if the debtor survived his mother. The debtor’s pre-bankruptcy transfer of his contingent remainder interest was avoided as in fraud of creditors.

A transfer of a corporation’s good will to a new corporation was held to be in fraud of creditors in the case of Airflow Houston, Inc. v. Theriot, 849 S.W.2d 928, 933 (Tex. App.–Houston 1st 1993, no writ). Transfer of the prior company’s logo, telephone number, address and use of a similar name is evidence of a fraudulent transfer of goodwill. Flores v. Robinson Roofing & Const. Co., 161 S.W.3d 750, 755 (Tex. App.–Fort Worth 2005, writ denied).

VII. HOWEVER, TRANSFER OF EXEMPT ASSETS MAY BE AVOIDED BY A BANKRUPTCY TRUSTEE

The rule is different under the Bankruptcy Code. A bankruptcy trustee has the power under § 548 of the Bankruptcy Code to avoid the debtor’s pre-bankruptcy transfer of exempt property. Most of the cases concern a pre-bankruptcy transfer of the debtor’s homestead, but the principle would apply to a pre-bankruptcy transfer of any exempt asset.

The trustee may recover a transfer of the debtor’s homestead as a transfer in fraud of creditors, notwithstanding that the property was exempt or exemptible. In re Owen, 104 B.R. 929 (C.D.Ill. 1989). The cases hold that the debtor waived the homestead exemption by making a voluntary transfer of the home. Matter of Wickstrom, 113 B.R. 339 (Bankr.W.D.Mich. 1990); In re Trujillo, 215 B.R. 200 (9th Cir. B.A.P. 1997), affirmed 166 F.3d 1218 (9th Cir. 1998). In addition, the transferee does not have standing to raise the debtor’s homestead exemption as a defense to the trustee’s suit against the transferee to recover the debtor’s former homestead or its proceeds. In re Noblit, 72 F.3d 757 (9th Cir. 1995).
VIII. A FRAUDULENT TRANSFER CLAIM MUST BE ASSERTED BY A LAWSUIT AND NOT IN CONNECTION WITH A POST JUDGMENT REMEDY

A cause of action to avoid a debtor's transfer of assets in fraud of the rights of creditors must be brought by a separate lawsuit, and cannot be raised in proceedings to enforce a judgment. A claim for relief pursuant to the Fraudulent Transfers Act requires a separate lawsuit and cannot be litigated by a motion for a post judgment turnover order. *Kennedy v. Nudnall*, 249 S.W.3d 520 (Tex. App.--Texarkana 200, no pet.). Nor can a fraudulent transfer claim be litigated as part of a contest of the bank's answer to a writ of garnishment. A garnishment proceeding may not be used to avoid a transfer in fraud of creditors or pierce the corporate veil or assert other remote claims to the funds. *Bank One, Texas, N.A. v. Sunbelt Savings, F.S.B.*, 824 S.W.2d 557 (Tex. 1992).

IX. TRANSFER MADE WITH ACTUAL INTENT TO HINDER, DELAY OR DEFRAUD CREDITORS

Tex. Bus. & Comm. Code § 24.005 provides:

(a) A transfer made or obligation incurred by a debtor is fraudulent as to a creditor, whether the creditor’s claim arose before or within a reasonable time after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation:

1. with actual intent to hinder, delay, or defraud any creditor of the debtor.

This section applies to any creditor of the debtor whose claim arose before or within a reasonable time after the transfer took place.

X. UNDER THIS THEORY, ACTUAL INTENT MUST BE SHOWN

The key element is the debtor’s actual intent and requires a finding by a jury or by the judge in a non-jury trial that the debtor had actual intent to hinder, delay or defraud creditors when the debtor made the transfer in question.

The intent which must be shown is different from intent required to prove actual fraud. *Nobles v. Marcus*, 533 S.W.2d 923 (Tex. 1976). It is not necessary to prove intent to deceive, or a false statement or representation, and it is not necessary to prove reliance by anyone. The intent which must be proved is actual intent to hinder, delay or defraud creditors. Where actual intent to hinder, delay or defraud creditors is found by the jury, it is irrelevant whether the debtor was insolvent at the time of the transfer. *Hawes v. Central Texas Production Credit Ass’n*, 492 S.W.2d 714 (Tex. Civ. App.–Austin 1973) *affirmed* 503 S.W.2d 234 (Tex. 1974).

XI. PREFERENCE OF ONE CREDITOR OVER ANOTHER IS NOT A FRAUDULENT TRANSFER

However, merely preferring one creditor over another is not enough. § 24.009(a) provides that

(a) A transfer or obligation is not voidable under Section 24.005(a)(1) of this code against a person who took in good faith and for a reasonably equivalent value or against any subsequent transferee or obligee.

The Texas Supreme Court has long recognized an exception to the fraudulent transfer statute in the case of preferences, that is payments or transfers of property by an insolvent debtor to one of his unsecured creditors in payment of a debt, if the value of the property does not exceed the amount of the debt and the creditor receives the money or property in good faith, that is, without a secret agreement to benefit the debtor in some way other than by discharge of his debt. *Hawes v. Central Texas Production Credit Ass’n*, 503 S.W.2d 234 (Tex. 1973).

A debtor may prefer one creditor over another creditor in applying its assets to discharge of obligations and paying one creditor instead of another is not normally a transfer in fraud of creditors. *Englert v. Englert*, 881 S.W.2d 517 (Tex. App.–Amarillo 1994, no writ).

XII. BADGES OF FRAUD

The statute lists certain factors which the trier of fact may consider to find intent to hinder, delay or defraud creditors. § 24.005(b) provides:

(b) In determining actual intent under Subsection (a)(1) of this section, consideration may be given, among other factors, to whether:

1. the transfer or obligation was to an insider;
2. the debtor retained possession or control of the property transferred after the transfer;
3. the transfer or obligation was concealed;
4. before the transfer was made or obligation was...
incurred, the debtor had been sued or threatened with suit;
(5) the transfer was of substantially all the debtor’s assets;
(6) the debtor absconded;
(7) the debtor removed or concealed assets;
(8) the value of the consideration received by the debtor was not reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred;
(9) the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred;
(10) the transfer occurred shortly before or shortly after a substantial debt was incurred; and
(11) the debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor.

In addition to the factors enumerated in § 24.005(b), the courts have identified several “badges of fraud” which indicate that the debtor had the intent to hinder, delay or defraud creditors:
(1) the existence of pending suits against the debtor at the time of the transfer;
(2) a transfer of all of the debtor’s property which is subject to execution;
(3) a blood relationship between the debtor and the transferee;
(4) a recitation of love and affection for the grantee as part of the consideration; and
(5) the value of the property transferred greatly exceeded debts assumed by the transferee as part of the conveyance.  *Texas Sand Company v. Shield*, 381 S.W.2d 48, 52-53 (Tex. 1964).

When several of these badges of fraud are present, the court may properly infer fraudulent intent.  *Metal Bldg Components, L.P. v. Raley*, 2007 WL 74316 (Tex. App.–Austin 2007, not reported in SW3d)

Fraudulent intent may be established as a matter of law, without necessity of a trial, if (1) the fraud is admitted by the debtor, (2) the fraudulent intent is apparent on the face of the instrument of conveyance, or (3) there is some interest reserved in the property by the debtor which is inconsistent with the purported conveyance.  *Texas Sand Company v. Shield*, 381 S.W.2d 48, 52-53 (Tex. 1964).

Where a limited liability company distributed excess cash flow to its owners, in proportion to their ownership interests, with knowledge that the distribution would prevent the company from making a payment on a promissory note, in the hopes that this would force the note holder to renegotiate the amount of the note downward, the distribution was found to have been made with actual intent to hinder and delay the note holder and was avoided as in fraud of creditors when the company later filed for Chapter 7.  *In re Brentwood Lexford Partners, LLC*, 292 B.R. 255 (Bankr. N.D.Tex. 2003).

**XIII. TRANSFER MADE WHILE INSOLVENT WITHOUT RECEIVING REASONABLY EQUIVALENT VALUE**

Tex. Bus. & Comm. Code § 24.006(a) provides:

(a) A transfer made or obligation incurred by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made or the obligation was incurred if the debtor made the transfer or incurred the obligation without receiving a reasonably equivalent value in exchange for the transfer or obligation and the debtor was insolvent at that time or the debtor became insolvent as a result of the transfer or obligation.

When these elements are shown, the debtor’s actual intent to defraud creditors is not a necessary element of proof. A transfer of assets made while insolvent not upon a consideration deemed valuable is voidable, whether or not it was the intent of the debtor to defraud.  *First State Bank v. Goodner*, 168 S.W.2d 941, 943 (Tex. Civ. App.–Amarillo 1943, no writ).

**XIV. PROOF OF INSOLVENCY**

Insolvency is defined in § 24.003:

(a) A debtor is insolvent if the sum of the debtor’s debts is greater than all of the debtor’s assets at a fair valuation.

(b) A debtor who is generally not paying the debtor’s debts as they become due is presumed to be insolvent.

In determining whether the debtor was insolvent at the time of the transfer, the value of the asset transferred is not included.  § 24.003(d).

Debts do not include an obligation to the extent it is secured by a valid lien on property of the debtor which is not included as an asset.  § 24.003(e).

This definition of insolvency is similar to the definition of insolvency under the Bankruptcy Code, except that the Bankruptcy Code definition includes all
property, whether or not it is subject to a valid lien and all debts, whether or not they are secured by liens upon property of the debtor. 11 U.S.C. § 101(32).

The debtor will most likely be in a better position to offer evidence of what his assets and liabilities were on the date of the transfer than the creditor. You should have proof that the debtor was insolvent on the date of the transfer in hand before filing a lawsuit to set aside the transfer.

Proving that the debtor was insolvent at the time that he made the transfer is often a problem for the creditor who seeks to attack the transfer. Merely proving that your client did not get paid is not proof that the debtor is insolvent. You must have proof that the debtor was insolvent at the time of the transfer in hand before you file the suit. Such evidence is a necessary prerequisite to maintaining a successful suit for avoidance of a fraudulent transfer.

Proof of insolvency may be obtained from an admission by the debtor as to when he became insolvent, such as in a post judgment deposition. If he testifies that he has no assets and is insolvent, ask him to testify as to when he first became insolvent. A financial statement furnished by the debtor showing insolvency, or a credit report showing that the debtor was generally not paying his debts when they came due, may prove that he was insolvent. An income tax return for a corporation should contain a balance sheet, which may show insolvency.

XV. PROOF OF NO REASONABLY EQUIVALENT VALUE RECEIVED IN EXCHANGE

Whether the transfer was made for reasonably equivalent value is normally a question of fact. Value is different from consideration, and the fact that the transfer is supported by a legal consideration is not enough to insulate the transfer from attack.

“Value” is defined in § 24.004(a):

(a) Value is given for a transfer or an obligation if, in exchange for the transfer or obligation, property is transferred or an antecedent debt is secured or satisfied, but value does not include an unperformed promise made otherwise than in the ordinary course of the promisor’s business to furnish support to the debtor or another person.

... (d) “Reasonably equivalent value” includes without limitation, a transfer or obligation that is within the range of values for which the transferor would have sold the assets in an arm’s length transaction.

An exact mathematical or dollar equivalent is not required, and both tangible and intangible assets which are received by the debtor should be included in the analysis. Airflow Houston, Inc. v. Theriot, 849 S.W.2d 928, 932 (Tex. App.–Houston [1st Dist.] 1993, no writ).

An old Texas Supreme Court opinion holds that for purposes of determining whether the debtor was insolvent, the value of the debtor’s equity in property heavily encumbered may be considered at the value it would probably bring if subject to forced sale. Walker v. Loring, 36 S.W. 246 (Tex. 1896).

Assumption by the transferee of a lien on the property transferred which was substantially less than the property’s value was not “Reasonably equivalent value.” Evans v. First Nat. Bank of Mt. Vernon, 65 S.W.2d 366, 368 (Tex. Civ. App.–Texarkana 1933, writ dism’d w.o.j.). Spiritual fulfillment is not reasonably equivalent value. Zahra Spiritual Trust v. U.S., 910 F.2d 248-49 (5th Cir. 1990).

A deed which recites nominal consideration such as $10 or “love and affection” is without reasonably equivalent value. Texas Nat. Bank of Beaumont v. Angelo, 102 S.W.2d 314, 315 (Tex. Civ. App.–Beaumont 1937, writ dism’d w.o.j.).

Giving additional security or additional collateral for an antecedent debt is “value” § 24.004(a). In the case of First Nat. Bank of Seminole v. Hooper, 104 S.W.3d. 83 (Tex. 2003), a back dated deed of trust given to secure an antecedent bank loan was held to be not in fraud of creditors because it was given for reasonably equivalent value. The court held that, as a matter of law, the value of an interest in an asset pledged as collateral for a pre existing debt is reasonably equivalent to the amount of the debt that it secures. First Nat’l Bank of Seminole v. Hooper, 104,S.W.3d 83, 84 (Tex. 2003).

XVI. TRANSFER WHILE INSOLENT TO AN INSIDER

Texas Business & Commerce Code § 24.006(b) provides:

(b) A transfer of assets is fraudulent as to existing creditors if, at the time the transfer was made, the debtor was insolvent and the transfer was made to an insider.
and the insider had reasonable cause to believe that the
debtor was insolvent.

§ 24.002(7) defines who is an insider as follows:

(7) “Insider” includes:
(A) if the debtor is an individual:
   (i) a relative of the debtor or of a general partner of
       the debtor;
   (ii) a partnership in which the debtor is a general
       partner;
   (iii) a general partner in a partnership described in
       Subparagraph (ii) of this paragraph; or
   (iv) a corporation of which the debtor is a director,
       officer, or person in control;
(B) if the debtor is a corporation:
   (i) a director of the debtor;
   (ii) an officer of the debtor;
   (iii) a person in control of the debtor;
   (iv) a partnership in which the debtor is a general
       partner;
   (v) a general partner in a partnership described in
       Subparagraph (iv) of this paragraph; or
   (vi) a relative of a general partner, director, officer,
       or person in control of the debtor;
(C) if the debtor is a partnership:
   (i) a general partner in the debtor;
   (ii) a relative of a general partner in, a general
       partner of, or a person in control of the debtor;
   (iii) another partnership in which the debtor is a
genral partner;
   (iv) a general partner in a partnership described in
       Subparagraph (iii) of this paragraph; or
   (v) a person in control of the debtor;
   (D) an affiliate, or an insider of an affiliate as if the
       affiliate were the debtor; and
   (E) a managing agent of the debtor.

However, the list provided by the act is not
intended to be exclusive. The Matter of Holloway, 955
F.2d 1008, 1010 (5th Cir. 1992); Putman Pension Plan
v. Stephenson, 805 S.W.2d 16, 18 (Tex. App.—Dallas
1991, no writ). Language in the Holloway case states
that factors which indicate that the transaction was not
conducted “at arms length” are relevant to determining
whether the transferee was an insider. Matter of
Holloway, 955 F.2d 1008, 1010 (5th Cir. 1992).

The administrator of a pension plan lender who
was a close personal friend of the debtor’s wife, was
held to be an insider. Putman Pension Plan v.
Stephenson, 805 S.W.2d 16 (Tex. App.—Dallas 1991, no
writ).

This statute makes preference by a debtor of
insiders voidable if the insider had reasonable cause to
believe that the debtor was insolvent.

In the case of Matter of Holloway, 955 F.2d 1008,
1010 (5th Cir. 1992), Mr. Holloway’s wife made a loan
to him which was initially unsecured. Subsequently,
Mr. Holloway signed a collateral assignment and
security agreement in favor of his wife concerning a
judgment which he held. The court held that this was
voidable under § 24.006(b).

Transfer of assets by a husband to his wife while
insolvent is void as to the husband’s creditors. Texas
Nat. Bank of Beaumont v. Angelo, 102 S.W.2d 314

XVII. INSIDER’S DEFENSES - SUBSEQUENT
NEW VALUE AND ORDINARY
COURSE OF BUSINESS

A transfer to an insider is not voidable under §
24.006(b) to the extent that the insider gave new value
to or for the benefit of the debtor after the transfer was
made, unless the new value was secured by a valid lien,
or if the transfer was made in the ordinary course of
business or financial affairs of the debtor and the
insider. § 24.009(f)(1) and (2).

These provisions are almost identical to the
preference defense provisions of § 547 of the U.S.
Bankruptcy Code. 11 U.S.C. § 547(c)(2) and (4). The
Official Comments to the Uniform Fraudulent Transfer
Act state that Section (1) is derived from § 547(c)(4) of
the U.S. Bankruptcy Code which makes it a defense to
avoidance of a preferential transfer that the creditor
extended new value to the debtor after receiving the
preference, and that Section (2) is derived from §
547(c)(3) of the U.S. Bankruptcy Code which makes it
a defense to avoidance of a preferential transfer that the
payment or transfer was made in the ordinary course of
business of the debtor.

There are no Texas case opinions decided un-der
these provisions. However, the question of what
constitutes a payment “in the ordinary course of
business” and what constitutes a subsequent transfer of
“new value” have been much litigated under the
Bankruptcy Code, and opinions from Federal Courts
and Bankruptcy Courts dealing with these questions
may be useful authority.

Under § 547(c)(4) of the U.S. Bankruptcy Code,
new credit extended to a debtor after receipt of a

One exception is rehabilitation loans by insiders to stave off insolvency. It is well settled law under the Bankruptcy Code that when an insider loan is made to stave off insolvency, repayment of the loan is not in the ordinary course of business and is not a defense to the trustee’s action to avoid a preference. In re Arctic Air Conditioning, Inc., 35 B.R. 107 (Bankr. E.D. Tenn. 1983). However, § 24.009(f)(3) of the Uniform Fraudulent Transfer Act protects rehabilitation loans from avoidance as a transfer in fraud of creditors. It provides that where an insider makes a loan to a debtor in a good faith effort to save the debtor from a forced liquidation in bankruptcy, or otherwise, and receives a pledge of the security interest in the debtor’s assets to secure the loan, the granting of the security interest is protected against avoidance.

XVIII. REMEDIES

Remedies available to a creditor who prevails in a suit to avoid a transfer in fraud of creditors are set forth in Tex. Bus. & Comm. Code § 24.008:

(a) In an action for relief against a transfer or obligation under this chapter, a creditor, subject to the limitations in Section 24.009 of this code, may obtain:

(1) avoidance of the transfer or obligation to the extent necessary to satisfy the creditor’s claim;

(2) an attachment or other provisional remedy against the asset transferred or other property of the transferee in accordance with the applicable Texas Rules of Civil Procedure and the Civil Practice and Remedies Code relating to ancillary proceedings; or

(3) subject to applicable principles of equity and in accordance with applicable rules of civil procedure:
   (A) an injunction against further disposition by the debtor or a transferee, or both, of the asset transferred or of other property;
   (B) appointment of a receiver to take charge of the asset transferred or of other property of the transferee; or
   (C) any other relief the circumstances may require.

(b) If a creditor has obtained a judgment on a claim against the debtor, the creditor, if the court so orders, may levy execution on the asset transferred or its proceeds.

The court has the power to issue a temporary injunction to block the transferee from making further transfer of the assets while the case is pending. Tanguy v. Laux, 259 S.W.3d 851 (Tex. App.–Houston 1st 2008, no pet.)

If a creditor seeks a judgment for money damages, the amount will be either the value of the asset transferred, at the time of the transfer, or the amount of the creditor’s claim, whichever is less. § 24.009(b). The judgment is based upon the value of the asset at the time of the transfer. § 24.009(c)(1). The value of the asset transferred is not to be adjusted to include the value of improvements made by a good faith transferee, including physical additions, repairs, payment of taxes, payment of liens, and preservation of the asset. § 24.009(c)(2). The transferee is entitled to either a reduction in the amount of his liability or a lien for the value of the improvements which he has made. § 24.009(d).

However, one court has held that the transferee is liable for the full amount of the creditor’s claim, regardless of the value of the property transferred. AirFlow Houston, Inc. v. Theriot, 849 S.W.2d 928, 933-34 (Tex. App.–Houston [1st Dist.] 1993, no writ). In that case, the judgment was upheld under § 24.008(a)(3)(C). The broad equitable remedy language of clause (C) permitted the court to award a judgment against the transferee for the full amount of the debt, regardless of whether the entire value of the asset or interest was ever received by the transferee. Trigueant Holdings, Ltd. v. Jones, 183 S.W.3d 717, 727 (Tex. App.–Houston 1st 2005, pet. denied). The Trigueant opinion cited Gutierrez v. Givens, 1 F.Supp.2d 1077, 1087 (S.D.Cal. 1998) interpreting the Uniform Fraudulent Transfer Act’s broad equitable remedy language to mean that full liability could be imposed upon the transferee if the transferee received fraudulently transferred assets in bad faith and in complicity with the debtor. Trigueant at 727.

XIX. GOOD FAITH PURCHASER FOR VALUE

It is a defense for the transferee to prove that the transferee took in good faith and for a reasonably equivalent value. § 24.009(a). Therefore, a good faith purchaser from the debtor who gives reasonably equivalent value for the asset will prevail even where it is found that the debtor acted with actual intent to defraud his creditors. The defense that he was a good
faith purchaser for value also protects a transfer to an insider of the debtor from avoidance.

XX. STATUTE OF LIMITATIONS

For transfers sought to be avoided on the ground that they were made with actual intent to defraud or on the ground that they were made while the debtor was insolvent without receiving reasonably equivalent value, the statute of limitations is four years from the date the transfer was made. Tex. Bus. & Comm. Code § 24.010 (a).

For transfers to an insider which are sought to be avoided under § 24.006 (b), the statute of limitations is one year after the transfer is made.

A discovery rule is contained within § 24.010 with respect to causes of action to avoid transfers made with actual intent to hinder, delay or defraud creditors and transfers made while insolvent without receiving reasonably equivalent value. § 24.010(a)(1) provides that a cause of action under these sections must be brought within four years after the transfer was made or the obligation was incurred or, if later, within one year after the transfer or obligation was or could have reasonably been discovered by the claimant. This one year limit on the discovery rule makes § 24.010 a statute of repose, rather than a statute of limitations. Cadle Co. v. Wilson, 136 S.W.3d 345, 350 (Tex.App.–Austin 2004). Therefore, five years after the date of the transfer is the outside date beyond which a transfer may not be avoided and the discovery rule cannot extend the period beyond five years from the date of the transfer.

The discovery rule applies to the date on which a cause of action accrues. Cadle Co. v. Wilson, 136 S.W.3d 345, 351 (Tex.App.–Austin 2004). The statutory period begins to run when the creditor first learned of the existence of the transaction, not the date on which the creditor first learned that the transfer was made with a fraudulent intent. Cadle Co. v. Wilson, 136 S.W.3d 345, 352 (Tex.App.–Austin 2004).

Where a fraudulent transfer suit is brought by one creditor, and other creditors intervene, the date of the filing of the original suit governs the statute of limitations as to all claimants, not the date of the intervention. Johnston v. Crook, 93 S.W.3d 263 (Tex.App.–Houston [14th Dist.] 2002).

For insider fraudulent transfers, the period for bringing a suit of one year from the date the transfer was made is an absolute bar, and there is no discovery rule. § 24.010(a)(3). However, if you don’t discovery a transfer to an insider until more than a year after it occurred, you are not out of luck. Recall that a transfer to an insider is a badge of fraud and you may be able to make a case that under the other sections of the statute.

The four year statute of limitations on fraudulent transfer claims under the Uniform Fraudulent Transfer Act does not apply to the IRS, since the statute of limitations does not run against the government. This may help a bankruptcy trustee. Where the IRS is a creditor in an estate, the bankruptcy trustee, under the trustee’s strong arm powers, is entitled to use whatever limitations period is available to any actual creditor who has a claim in the case. If the IRS is a creditor, then the trustee may overcome the statute of limitations. In re Porras, 312 B.R. 81 (Bankr.W.D.Tex. 2004).

XXI. FRAUDULENT TRANSFERS UNDER THE BANKRUPTCY CODE

Section 548 of the Bankruptcy Code provides:

The trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within two years before the date of the filing of the petition, if the debtor voluntarily or involuntarily--

(1) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted;

or

(2) received less that a reasonably equivalent value in exchange for such transfer or obligation; and was insolvent on the date such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation.

By operation of § 544 of the Bankruptcy Code, all state law fraudulent transfer claims are also vested in the trustee. Carlton v. BAWW, Inc., 751 F.2d 781 (5th Cir. 1985). Therefore, the Bankruptcy Trustee owns all causes of action for recovery of the debtor’s assets which were transferred in fraud of creditors, and the trustee may sue to avoid fraudulent transfers under State law and may assert causes of action under Chapter 24 of the Texas Business & Commerce Code. Although the statutes are virtually identical, the trustee may need to use the State statute because of the four year period of limitations, since § 548 of the Bankruptcy Code can only reach transfers made within one year of the filing of the bankruptcy petition.
Upon the filing of a Bankruptcy Petition, the Bankruptcy Trustee is the only person who may assert such causes of action and any pending lawsuits to avoid fraudulent transfers become an asset of the bankruptcy estate and thereafter, only the trustee may pursue the lawsuit. If conflicts of interest can be avoided or waived, the trustee may hire the lawyer who filed the lawsuit for a creditor to continue the lawsuit on behalf of the trustee. The trustee must file an application with the Bankruptcy Court for authority to employ the lawyer to represent the trustee in the lawsuit and the lawyer must apply to the Bankruptcy Court to be allowed compensation for his services, like any other professional in a bankruptcy case.

A hot issue under the Bankruptcy Code is the opinion of *In re Tousa, Inc.*, 422 B.R. 783 (Bankr.S.D.Fla 2009) which applied the Uniform Fraudulent Transfer Act to transfers between and for the benefit of closely related family of corporations in a parent/subsidiary relationship. The official creditors committee was able to unwind the transactions and set aside loans made by and liens granted to Citicorp in the amount of $600 million. The opinion created problems for banks seeking to make loans to a family of insolvent corporations. It inspired trustees to seek to avoid all payments to creditors on account of related subsidiary debts as fraudulent transfers, and to seek to impose personal liability upon the officers and directors of debtor corporations for making such inter subsidiary transfers.

XXII. CONVERTING NON EXEMPT ASSETS INTO EXEMPT ASSETS IS OK UNDER TEX. BUS. & COMM. CODE CHAPTER 24

Texas courts have held that it is not in fraud of creditors for a debtor to dispose of non exempt property and apply the proceeds to purchase a homestead or to discharge a mortgage on his homestead. *Chandler v. Wellborn*, 294 S.W.2d 801, 805 (Tex. 1956; *Crow v. First Nat. Bank of Whitney*, 64 S.W.2d 377, 379 (Tex. Civ. App.–Waco 1933, writ ref’d); *Shaw v. Warren*, 68 S.W. 588, 590 (Tex. Civ. App.–Eastland 1933, no writ).

XXIII. HOWEVER, CONVERTING NON EXEMPT ASSETS INTO EXEMPT ASSETS MAY BAR A DISCHARGE UNDER THE BANKRUPTCY CODE

In a case under Chapter 7 of the Bankruptcy Code, a discharge may be denied if the debtor, with intent to hinder, delay, or defraud a creditor, has transferred, removed, destroyed or concealed property of the debtor, within one year before the date of the filing of the petition. 11 U.S.C. § 727(a)(2); *In re Womble*, 289 B.R. 836 (Bankr.N.D.Tex. 2003).

Bankruptcy Courts have held that the simple fact that the debtor converted some non exempt assets into exempt assets is not, by itself, enough to bar a discharge under this section, and that some bankruptcy planning is allowed. To determine what actions of converting non exempt property into exempt property amount to intent to hinder, delay or defraud creditors sufficient to bar a discharge, the Fifth Circuit has adopted the “pig to hog” analysis. Pigs get fat, but “when a pig becomes a hog it is slaughtered.” *Matter of Bowyer*, 916 F.2d 1056, 1060 (5th Cir. 1990).

In that case, Mr. Bowyer, on the eve of bankruptcy, sold $18,000 in gold Mapleleafs and spent the proceeds on travel, clothing, furniture and home improvements. The Fifth Circuit reversed the Bankruptcy Court and the District Court and denied a discharge to Mr. Bowyer.

XXIV. CONVERTING NON EXEMPT ASSETS INTO A HOME STEAD MAY BE AVOIDABLE BY A BANKRUPTCY TRUSTEE

One of the changes made by the Bankruptcy Reform Act of 2005 was to add to the U.S. Bankruptcy Code § 522(o) which provides that the value of the debtor’s exempt interest in a homestead is reduced to the extent attributable to any nonexempt property that the debtor disposed of for the purpose of increasing the debtor’s equity in the homestead. The look back period for this subsection is ten years, and the objecting party has to show that the debtor disposed of the nonexempt property with the intent to hinder, delay, or defraud one or more creditors.


In the case of *In re Sissom*, 366 B.R. 677 (Bankr. S. D. Tex 2007), an opinion by Judge Jeff Bohm, the debtor sold 500 shares of stock and used $50,000 to pay the down payment to purchase a home which the debtor claimed as a homestead. Using the ‘badges of fraud’
analysis, the court sustained the Trustee’s objection to the homestead exemption to the extent of $50,000 and granted the Trustee an equitable lien on the home for the sum of $50,000.

XXV. LENDER LIABILITY FOR TAKING SECURITY INTEREST IN PARENT COMPANY’S ASSETS FOR LOAN TO SUBSIDIARY

In the case of In re Tousa, Inc., 422 B.R. 783 (Bankr.S.D Fla. 2009), a loan made by Citicorp to a failing developer to stave off insolvency was held to be in fraud of the rights of creditors, in particular, the company's bondholders. A Florida Bankruptcy judge ruled that loans made to Tousa, Inc. ahead of the home builder's bankruptcy filing were fraudulent transfers, and ordered Citicorp to pay more than $600 million. During the real estate boom, Tousa, Inc. purchased a developer and made it a subsidiary. When the market turned, Tousa, Inc. borrowed on its own credit to pay off the lenders of the subsidiary and pledged its own assets as collateral. The Official Creditors Committee objected that this was in fraud of the rights of Tousah’s bond holders, and the judge agreed with them.

XXVI. DEBTOR MAY NOT BE ALLOWED TO UNDO A TRANSFER IN FRAUD OF CREDITORS

In the case of Poe v. Hamlin Nat. Bank, 921 S.2d 515 (Tex. App.–Eastland 1996), Mr. Poe had liability to Citicorp for $100,000 upon a guaranty of a corporate debt, and expected to be sued. Mr. Poe owned substantial interests in oil and gas properties and he wanted to protect them from Citicorp. Mr. Poe had outstanding personal loans to the Hamlin National Bank, which he was paying, and which were not in default. Mr. Poe alleged that he made a verbal agreement with an officer of the bank to make a pretend mortgage of his oil and gas properties to the bank to protect the assets from Citicorp. At Mr. Poe’s request, the bank prepared and he signed deeds of trust and security agreements to various oil and gas properties pledging them to secure the bank loans. Mr. Poe alleged that he had a private agreement with the bank officer that the bank would reconvey the assets to him at any time on request, and he sued the bank for breach of that agreement. The court held that Mr. Poe was not entitled to recover because he was seeking to regain property which he had transferred in order to hinder, delay, or defraud creditors in violation of Chapter 24 of Tex. Bus. & Comm. Code. The courts will not aid a grantor to regain property which he has transferred to a grantee in order to defraud creditors. Poe v. Hamlin Nat. Bank, 921 S.W.2d 515, 517 (Tex. App.–Eastland 1996,writ denied).

XXVII. CONSPIRACY

Conspiracy is a derivative tort requiring an unlawful means or purpose, which may include an underlying tort. In the case of Chu v. Hong, 185 S.W.3d 507 (Tex. App.–Fort Worth 2005, reversed), the Court of Appeals affirmed a judgment where a jury found that an attorney conspired with his client to transfer assets of a family business to place the assets beyond the reach of his former wife. The husband fled the country with the proceeds. The wife obtained a judgment against the attorney for the value of the assets and also was awarded $1,500,000 punitive damages against the attorney. The Fort Worth Court of Appeals held that, since the conduct of the attorney was intentionally in fraud of creditors, he was not entitled to the normal legal theories which protect lawyers from liability to parties who are opposed to their clients of absence of privity and the litigation privilege.

However, the Texas Supreme Court reversed the judgment on the ground that the wife’s rights in the assets arose from the community property law and under Texas community property law there is no independent tort cause of action for wrongful disposition by a spouse of community assets. Chu v. Hong, 249 S.W.3d 441 (Tex. 2008). The theory may have some vitality in a non divorce context.

XXVIII. PIERCING THE CORPORATE VEIL

The corporate entity may be disregarded, even though corporate formalities have been observed, when the corporate form has been used as part of a basically unfair device to achieve an inequitable result. The corporate fiction is disregarded when it is used to perpetrate fraud, as a mere tool or business conduit of another corporation, as a means of evading existing legal obligations, to achieve or perpetrate monopoly, to circumvent a statute, or to protect crime or justify wrong. Castleberry v. Branscum, 721 S.W.2d 270 (Tex. 1986).

The Castleberry case permitted piercing the corporate veil for constructive fraud. However, Tex. Bus. Corp. Act Art. 2.21, A (2), effective August 28, 1989, eliminated constructive fraud or mere failure to observe corporate formalities as a ground for piercing the corporate veil in contract cases. Proof of actual fraud is required.
Those acts which will cause the court to pierce the corporate veil include the commencement of business without the issuance of shares, a lack of shareholder or directors meetings, failure to sign consents, decisions being made by shareholders as if they were partners, failure to distinguish between corporate property and personal property, use of corporate funds to pay personal expenses without requisite proper accounting, or failure to maintain complete corporate and financial records. *Wolf v. Little John Corp. of Liberia*, 585 S.W.2d 774 (Tex. Civ. App.–Houston 1st 1979, writ ref’d, n.r.e.); *Roylex, Inc. v. Langston Bros. Const. Co.*, 585 S.W.2d 768 (Tex. Civ. App. Houston 1st 1979, writ ref’d, n.r.e.).

Subsequent events such as failure of the corporation does not afford a basis of finding of fraud in the inception of the corporation. The plaintiff must show by evidence that the financial setup of the corporation is a sham and accomplishes injustice. *Holmes v. Clow*, 533 S.W.2d 99 (Tex. Civ. App.–Tyler, 1976, writ ref’d, n.r.e.).

In a breach of lease case, testimony that the corporation which was the tenant was intentionally a shell supported a finding of fraud sufficient to impose liability on a related corporation and the owner. *Dick’s Last Res. of West End v. Market/Ross*, 273 S.W.3d 905 (Tex. App.–Dallas 2008, petition denied).

A friendly foreclosure whereby the debtor corporation’s assets were sold by the secured creditor to a new corporation set up by the same person to assume the loan and continue the business of the first corporation without retaining responsibility for unsecured creditors of the debtor was sufficient grounds to pierce the corporate veil and subject the new corporation to the debts of the old corporation. *Klein v. Sporting Goods, Inc.*, 772 S.W.2d 173 (Tex. App.–Houston 14th 1989, writ denied).

Knowledge by outside co-owner of fraudulent conduct of inside co-owner including use of one entity to pay another entity’s bills, who did nothing to stop the fraudulent practices, was sufficient to pierce the corporate veil as to both co-owners. *McCarthy v. Wani Ventures, A.S.*, 251 S.W.3d 573 (Tex. App.–Houston 1st 2007, no petition).

**XXIX. ALTER EGO**

Where management and operations are assimilated to the extent that the subsidiary is simply a name or conduit through which the parent conducts its business, the corporate fiction may be disregarded to prevent fraud or injustice. *Gentry v. Credit Plan Corporation of Houston*, 528 S.W.2d 571 (Tex. 1975).

The corporate entity may be disregarded when there exists such unity between the corporation and an individual that the corporation ceases to be separate and when holding only the corporation liable would promote injustice. *Castleberry v. Branscum*, 721 S.W.2d 270 (Tex. 1986). Formerly, mere noncompliance with corporate formalities and payment of corporate debts with personal checks was sufficient evidence to support a finding of alter ego. *Mancorp, Inc. v. Culpepper*, 802 S.W.2d 226 (Tex. 1990). However, Tex. Bus. Corp. Act Art. 2.21, A (3), effective August 28, 1989, eliminated mere failure to observe corporate formalities as a ground for holding shareholders liable for corporate debts. Proof of actual fraud is required.

Alter ego relationship between corporate entity and the individual may be shown from total dealings of the corporation and individual. *Mancorp, Inc. v. Culpepper*, 802 S.W.2d 226 (Tex. 1990). Non compliance with corporate formalities and payment of corporate debts with personal checks was sufficient evidence of alter ego. *Id.*


A person who is not a shareholder of the corporation cannot be its alter ego. *George v. Houston Boxing Club, Inc.*, 423 S.W.2d 123 (Tex. Civ. App.–Houston 14th 1967, writ ref’d, n.r.e.).

Failure to follow corporate formalities and undercapitalization of the corporation are not enough. *Torregrossa v. Szec*., 603 S.W.2d 803 (Tex. 1980).

Where a party knowingly contracts with a corporation, it cannot impose liability upon the owners under the alter ego theory. *Angus v. Air Coils, Inc.*, 567 S.W.2d 931 (Tex. Civ. App.–Dallas 1978, writ ref’d, n.r.e.).

There must be some attempted use of a corporate vehicle in a fraudulent manner or in a manner which would ordinarily defraud an unsuspecting or good faith third party. *Paine v. Carter*, 469 S.W.2d 822 (Tex. Civ.
XXXI. FORFEITURE OF A CORPORATION’S RIGHT TO DO BUSINESS

If a corporation has had its right to do business forfeited by the Secretary of State for nonpayment of franchise taxes, and the corporation incurs a debt or obligation after its right to do business has been forfeited, each officer or director of the corporation is personally liable for the debt, unless the officer or director can show that he objected to the incurrence of the debt or that the debt was created without his knowledge. Tex. Tax Code § 171.255. The officers and directors are not required to have personally participated in the transactions resulting in the corporate debt, but rather it is the director’s or officer’s consent to and approval or the corporate debt that leads to their personal liability. In re Trammell, 246 S.W.3d 815, 821-22 (Tex. App.–Dallas 2008, no pet.). The time at which personal liability of the officers of the corporation attaches is when the contract was made, not when the breach occurred. Williams v. Adams, 74 S.W.3d 437, 443 n.2 (Tex. App.–Corpus Christi 2002, pet. denied).

Subsequent payment of the franchise taxes and reinstatement of the corporation’s right to do business does not defeat the personal liability of the officers and directors for debts incurred during the time that the right to do business was forfeited. Hicks v. Continental Carbon Paper Mfg. Co. of Dallas, 380 S.W.2d 737 (Tex. Civ. App.–Waco 1964, writ ref’d, n.r.e.).

But, subsequent forfeiture of the corporation’s right to do business does not make the owners personally liable on a corporate debt incurred while the corporate charter was active. Roylex, Inc. v. Langston Bros. Const. Co., 585 S.W.2d 768 (Tex. Civ. App.–Houston 1st 1979, writ ref’d, n.r.e.). If the right to do business is subsequently forfeited, personal liability attaches on the day after the franchise tax and report was due. Dae Won Choe v. Chancellor, Inc., 823 S.W.2d 740 (Tex. App.–1992, no writ). Franchise tax reports and margin tax payments are due on May 15 following each tax year.

XXXII. TRUST FUND DOCTRINE

When an insolvent corporation ceases to do business, its assets are impressed with a trust in favor of its creditors, and directors and shareholders who receive corporate assets are liable to creditors, to the extent of the value of the assets received. Henry I. Siegel Co., Inc. v. Holliday, 663 S.W.2d 824, 827 (Tex. 1984); Waggoner v. Herring-Showers Lumber Co., 120 Tex. 605, 40 S.W.2d 1 (1931); World Broadcasting System, Inc. v. Bass, 328 S.W.2d 863 (Tex. 1959).
XXXIII. ORAL GUARANTY UNDER THE "MAIN PURPOSE" DOCTRINE

The statute of frauds makes an oral guaranty unenforceable. Tex. Bus. & Comm. Code Sec. 26.01(b)(2). However, the "main purpose" doctrine is an exception to this rule. When the main purpose of the oral promise is to obtain some benefit to or consideration for the promissor, the oral promise is outside of the bar of the statute of frauds. Cooper Petroleum Co. v. LaGloria Oil and Gas Co., 436 S.W.2d 889 (Tex. 1969); Haas Drilling Co. v. First National Bank in Dallas, 456 S.W.2d 886 (Tex. 1970).