Protecting the Integrity of the Entity-Specific Contract: The "No Recourse Against Others" Clause—Missing or Ineffective Boilerplate?

*By Glenn D. West and Natalie A. Smeltzer** | Author Bios

When business lawyers form corporations and other limited-liability entities to be the specified contracting party to a written agreement, they generally assume that the contracting entity's parent and affiliates will be insulated from the obligations and liabilities incurred in connection with that entity-specific contract. Too often, this assumption, which is based solely upon the protection provided through the modern limited-liability regimes created by various state statutes, is challenged by equitable and tort-based theories asserted by a disappointed counterparty seeking recourse from persons with whom it did not contract. These challenges are successful more often than is sometimes thought. The authors believe that the owners, directors, and officers of limited-liability entities would obtain substantial benefit from supplementing the limited liability granted through statute with a specifically negotiated contractual provision. While the "no recourse against others" clause commonly found in corporate indentures is a helpful starting point for developing such a provision, this clause may not be as effective against the modern threats to limited liability as some may think because it was originally created to guard against threats that have been largely assigned to the history vaults. Accordingly, consistent with the private equity industry's modern adaptation of this clause in the context of the documentation of mergers and acquisitions, the authors propose an overhaul of the historical "no recourse against others" clause and an expansion of the use of this updated and modernized clause to all entity-specific contracts.

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I. Introduction

For today's business lawyer, it is an accepted principle of corporate law that the corporate entity normally insulates its shareholders, directors, and officers from individual liability for the debts and obligations of that corporate entity.[1] Based on this principle, subsidiary corporations and other limited-liability entities are formed every day to enter into entity-specific contracts.[2] The goal in doing so, of course, is to shield that subsidiary's owners and affiliates from the obligations and liabilities incurred in connection with that entity-specific contract. Most business lawyers understand that the liability protection provided by the interposition of a subsidiary is not absolute. However, the authors believe that there is an under-appreciation of the potential for actual liability leakage through the seemingly sacrosanct statutory seal, particularly when that liability arises from a freely negotiated agreement where the subsidiary is the only named counterparty. And, even when the statutory seal ultimately remains secure, it sometimes does so only after an appeal from a jury verdict on the heels of lengthy and expensive litigation brought by a counterparty to the entity-specific contract that, having failed to bargain for direct contractual liability against the parent or its affiliates, seeks to impose liability on nonparty affiliates of the contracting subsidiary based upon various tort and piercing-the-veil theories.

This article suggests that an entity-specific contract creates a clear opportunity to use the principles of contractual freedom to augment the statutory protection provided through the various limited-liability regimes. The authors further

1. *See, e.g.*, Phillips v. United Heritage Corp., 319 S.W.3d 156, 158 (Tex. App. 2010); Glenn D. West & Stacie L. Cargill, *Corporations*, 62 SMU L. Rev. 1057, 1059–60 (2009).

2. By "entity-specific contract," we mean any agreement to which one of the parties is a limited-liability entity owned by another limited-liability entity or by an individual or group of individuals or other entities, but as to which the parent or other owners or affiliates of the entity party are not named as parties and for which they have not otherwise agreed to become liable pursuant to a guaranty.

suggest that by borrowing from the historical use of the "no recourse against others" clause commonly found in bond indentures and from the modern adaptation of this clause in the context of merger and acquisition transactions involving a private equity firm, there is an easily adaptable contractual provision that could be made a part of the boilerplate of all entity-specific contracts. By adding such a provision, the authors believe that the statutory limited-liability seal is contractually reinforced to make it more difficult for disappointed counterparties to impose liability on nonparty affiliates of the other named contracting party.

We begin by providing a brief history of the corporation and the statutory grant of limited liability that modern business lawyers take for granted. We then review the early historical use, and the courts' treatment of, the "no recourse against others" clause still commonly found in indentures today. Next, we discuss the modern principles of corporate and limited-liability entity law, as well as the current threats to the limited liability assumed to exist when a subsidiary is the only named counterparty to a contract, threats that are materially different than those facing the 19th and early 20th century business lawyers who created the original "no recourse against others" clause. Then, we examine the Model Bond Provisions and discuss some of the cases from the modern era that have considered various versions of the "no recourse against others" clause in current use today. Additionally, we review the modern adaptation of these clauses in the context of the private equity industry. Finally, we propose some updating and revision to the "no recourse against others" clause to address more fully the current threats to the presumption of limited liability.

II. A Brief History of the Corporation and the Statutory Grant of Limited Liability

Despite the early recognition of the corporation as an entity distinct from its shareholders,[3] the limited-liability regimes that business lawyers now take for granted in connection with the corporate form are a fairly recent addition to the law. Indeed, some have argued that "limited liability is not a *necessary* characteristic of incorporation of [a] commercial enterprise."[4] The original 1844 act authorizing the creation of joint-stock companies in the United Kingdom was primarily

3. 1 William Blackstone, Commentaries *467 (The corporation is "a person that never dies; in like manner as the river Thames is still the same river, though the parts which compose it are changing every instant."); Dole Food Co. v. Patrickson, 538 U.S. 468, 474 (2003) ("A basic tenet of American corporate law is that the corporation and its shareholders are distinct entities." (citing First Nat'l City Bank v. Banco Para El Comercio Exterior de Cuba, 462 U.S. 611, 625 (1983))); *see generally* John Dewey, *The Historic Background of Corporate Legal Personality*, 35 Yale L.J. 655 (1926); Arthur W. Machen, Jr., *Corporate Personality*, 24 Harv. L. Rev. 253 (1911); Samuel Williston, *A History of the Law of Business Corporations Before 1800*, 2 Harv. L. Rev. 105, 106 (1888).

Notwithstanding this early recognition of the corporation as an entity legally distinct from its shareholders for certain purposes, the doctrine remained muddled because of the underlying assumption that corporations, like partnerships, "were simply artificial aggregations of individuals." Morton J. Horwitz, Santa Clara *Revisited: The Development of Corporate Theory*, 88 W. Va. L. Rev. 173, 181 (1985).

4. John Smillie, *Tort, Contract and the Limited Liability Company: Reflections on* Trevor Ivory Ltd v. Anderson, 14 N.Z. Bus. L.Q. 96, 99 (2008); *see also* Susan Pace Hamill, *From Special Privilege to General Utility: A Continuation of Willard Hurst's Study of Corporations*, 49 Am. U. L. Rev. 81, 91 n.42 (1999).

created to allow free transferability of shares and continuity of existence independent of the members of the company, not to limit liability for its members.[5] In fact, that act specifically "*preserved* the full personal liability of members for company debts."[6] It was not until 1855 that a subsequent act was passed granting limited liability to shareholders of the corporate entity.[7]

The United States was even slower in recognizing full limited liability. Well into the early 20th century, various state statutes and charters authorizing the creation of corporations actually imposed, rather than limited, the personal liability of shareholders for the debts of the corporation.[8] Some of these statutes imposed personal liability on each shareholder for the corporation's debt "in proportion to the percentage of the equity that they own[ed] in the company."[9] Others imposed personal liability on shareholders based on a "multiple of two or three times the value of their investments."[10]

In the early days, many corporate charters imposed liability on shareholders by allowing assessments that could be enforced in equity by aggrieved creditors.[11] Similarly, the difference between the price paid for the stock and its par value remained an obligation of each shareholder that could be enforced in equity by creditors.[12] Historical concern over these issues may help explain the persistence of a representation in modern agreements regarding the ownership of the stock being sold; i.e., that such stock is "fully paid and nonassessable."[13]

Even after corporate statutes began to establish a liability shield for corporate shareholders in the United States, shareholders largely remained individuals and the corporate statutes did not ordinarily allow corporations to own shares in other corporations.[14] It was not until 1890 in New Jersey that holding companies were officially accepted; thereafter, that acceptance eventually migrated to all of the other states.[15] The statutory grant of limited liability thus extended from protecting the individual investors in a corporate entity to protecting a parent corpora-

5. *See* Smillie, *supra* note 4, at 99.

6. *Id.*

7. *Id.*

8. *Id.* at 100; *see also* Timothy P. Glynn, *Beyond "Unlimiting" Shareholder Liability: Vicarious Tort Liability for Corporate Officers*, 57 VAND. L. REV. 329, 337–40, 363 (2004). *But see* W. J. Carney, *Limited Liability*, ENCYCLOPEDIA OF LAW AND ECONOMICS, http://encyclo.findlaw.com/5620book.pdf (last visited Dec. 12, 2011) (suggesting that most U.S. states provided full limited liability to corporations after the mid-nineteenth century).

9. Smillie, *supra* note 4, at 102.

10. *Id.*

11. *See* Douglas Arner, *Development of the American Law of Corporations to 1832*, 55 SMU L. REV. 23, 45–46 (2002); Phillip I. Blumberg, *Limited Liability and Corporate Groups*, 11 J. CORP. L. 573, 580–81, 589–90 (1986); E. Merrick Dodd, *The Evolution of Limited Liability in American Industry: Massachusetts*, 61 HARV. L. REV. 1351, 1356–57 (1948); Joel Seligman, *A Brief History of Delaware's General Corporate Law of 1899*, 1 J. CORP. L. 248, 255 (1976).

12. Herbert Hovenkamp, *The Classical Corporation in American Legal Thought*, 76 GEO. L.J. 1593, 1655–58 (1988).

13. *See* Carlos L. Israels, *Problems of Par and No-Par Shares: A Reappraisal*, 47 COLUM. L. REV. 1279, 1280 (1947).

14. Phillip I. Blumberg, *The Transformation of Modern Corporation Law: The Law of Corporate Groups*, 37 CONN. L. REV. 605, 607 (2005).

15. *Id.*; *see also* Hamill, *supra* note 4, at 116.

tion that formed subsidiaries to engage in specific new enterprises for the benefit of that corporate parent.[16]

Despite the fact that the limited-liability regime has been trumpeted as having fueled the industrial revolution[17] by allowing entrepreneurs "to stake only a part of their fortune on an enterprise,"[18] limited liability has been a very controversial concept from the very beginning.[19] Indeed, "for much of the 19th century the limited liability company was an object of suspicion—a likely means of deception, a creature of wild and evanescent schemes, the antithesis of the solid and respectable."[20] Even Adam Smith, the great defender of capitalism, rejected limited liability as a general proposition, suggesting "that it encouraged irresponsible risk-taking by principals and management."[21] He was, however, supportive of limited liability for major undertakings for the public benefit.[22] Further, there was general acceptance of the need for limited liability for railroads.[23]

On the other hand, recognition of the corporation as an entity independent of its members has been argued to inevitably lead to limited liability.[24] Some have even suggested that there is evidence of an early acceptance in the common law that, in the absence of an express imposition of liability on shareholders in the charter granting the corporation its status, shareholders had no liability for the

16. Blumberg, *supra* note 14, at 610; *see generally* William Randall Compton, *Early History of Stock Ownership by Corporations*, 9 Geo. Wash. L. Rev. 125, 130–32 (1940).

17. *See The Key to Industrial Capitalism: Limited Liability*, Economist (Dec. 23, 1999), http://www.economist.com/node/347323?story_id=347323. Indeed, in 1926, *The Economist* declared:

> The economic historian of the future, viewing in perspective the enormous expansion in the world's trade and industry during the nineteenth and twentieth centuries, may be inclined to assign to the nameless inventor of the principle of limited liability, as applied to trading corporations, a place of honour [sic] with Watt, Stephenson, and other pioneers of the Industrial Revolution. The genius of these men produced the means by which man's command of natural resources was multiplied many times over; the limited liability company the means by which the huge aggregations of capital required to give practical effect to their discoveries were collected, organized and efficiently administered.

The Ownership of British Industrial Capital, Economist, Dec. 18, 1926, at 1053.

18. William O. Douglas & Carol M. Shanks, *Insulation from Liability Through Subsidiary Corporations*, 39 Yale L.J. 193, 193–94 (1929); *see also* West & Cargill, *supra* note 1, at 1060 n.17.

19. *See* Hovenkamp, *supra* note 12, at 1651.

20. Smillie, *supra* note 4, at 99 (internal quotation omitted). Justice Brandeis described the corporation and the laws that were enacted to allow its existence as a "Frankenstein monster," and he even suggested that the corporation was largely responsible for the Great Depression. *See* Louis K. Liggett Co. v. Lee, 288 U.S. 517, 566–67 (1933) (Brandeis, J., dissenting).

21. Smillie, *supra* note 4, at 100.

22. *Id*. at 100 n.25.

23. *See* Blumberg, *supra* note 11, at 584.

24. *See id*. at 577; *see also* Machen, *supra* note 3, at 260 ("All that the law can do is to recognize, or refuse to recognize, the existence of this entity. The law can no more create such an entity than it can create a house out of a collection of loose bricks. If the bricks are put together so as to form a house, the law can refuse to recognize the existence of that house—can act as if it did not exist; but the law has nothing whatever to do with putting the bricks together in such a way that, if the law is not to shut its eyes to facts, it must recognize that a house exists and not merely a number of bricks.").

corporation's debts.[25] Thus, some argue that the assumption that limited liability would never exist absent the state-granted privilege[26] is essentially false.[27]

But whether this view is correct, long before the advent of statutorily recognized limited-liability regimes, business lawyers were crafting contractual provisions to limit liability to segregated assets of a particular business enterprise. In fact, despite the dominance of general partnerships as the main business model during much of the 19th century, with unlimited liability for all partners,[28] the segregation of assets to support specific liabilities, with no recourse to other assets, has a long history in private agreements independent of any statutorily mandated limits on recourse.[29] And, as will be seen in our discussion of the history of the "no recourse against others" clause, there has long been a recognition that parties to a contract with a business entity can specifically contract for liability not to extend to the members of that entity.[30] Indeed, one of the reasons the U.K. Parliament declined to grant limited liability statutorily as part of the original 1844 act authorizing general incorporation was a recognition that "creditors and debtors could contract for the desired result in any event."[31] In the modern piercing-the-veil context, courts have similarly looked to the fact that a party could have contracted for a guarantee from a corporation's owners, and did not do so, as a basis for refusing to pierce the veil.[32] Thus, the freedom to contract for limited liability in the early days fared better in many respects than the statutory grant of it has fared in the modern era.

III. Early History of the "No Recourse Against Others" Clause

The contractual freedom to disclaim personal liability for the benefit of members of an entity, where the law otherwise imposes that personal liability for the

25. *See generally* Dodd, *supra* note 11, at 1356–61; Hovenkamp, *supra* note 12, at 1651; *see also* French v. Teschemaker, 24 Cal. 518, 540 (1864) ("At common law no individual liability is imposed upon the members of a corporation, and there is therefore no department of the common law to which we can look for such a rule, except that which relates to partnerships or associations formed for trading purposes.").

26. *See* Larry E. Ribstein, *Limited Liability and Theories of the Corporation*, 50 Md. L. Rev. 80, 85–87 (1991).

27. *See* Paul G. Mahoney, *Contract or Concession? An Essay on the History of Corporate Law*, 34 Ga. L. Rev. 873 (2000).

28. *See* Paddy Ireland, *Limited Liability, Shareholder Rights and the Problem of Corporate Irresponsibility*, 34 Cambridge J. Econ. 837, 840 (2010); *see also* Paul Halpern, Michael Trebilcock & Stuart Turnbull, *An Economic Analysis of Limited Liability in Corporation Law*, 30 U. Toronto L.J. 117, 129 (1980).

29. *See* Blumberg, *supra* note 11, at 582, 615–16; Mahoney, *supra* note 27, at 885.

30. *See* Wesley Newcomb Hohfeld, *Nature of Stockholders' Individual Liability for Corporation Debts*, 9 Colum. L. Rev. 285, 296–97 (1909) (discussing English common law doctrines that provide for partners or shareholders to limit their liability by agreement with creditors); Ribstein, *supra* note 26, at 113.

31. Mahoney, *supra* note 27, at 890–91.

32. Phillip I. Blumberg & Kurt A. Strasser, *Corporate Groups and Enterprise Liability: Contracts and Torts, in* Protecting the Corporate Parent 1992: Avoiding Liability for Acts of the Subsidiary 177 (PLI Corp. L. & Prac. Course Handbook Series No. B-785, 1992).

benefit of a contractual counterparty of that entity, has long been recognized.[33] Indeed, in a 19th-century case involving the estate of the founder of Stanford University, the Ninth Circuit declared:

> It is well-settled law that the creditor of a corporation may, by express contract at the time the debt is incurred, waive his right to collect from the stockholders debts which the corporation may fail to pay. If a person chooses to deal with a partnership or joint-stock company upon the terms that its funds, and they only, shall be available to make good his demands, he cannot afterwards depart from those terms, and hold the members individually liable, as if no such restriction had been agreed to.[34]

Because corporate statutes did not consistently grant shareholders the kind of limited-liability protection that we take for granted today, business lawyers of the 19th and early 20th centuries designed the "no recourse against others" clause to create limited liability contractually where some state statutes not only did not insulate shareholders and directors from personal liability, but actually imposed it.[35] The fact that the statutory regimes of the various states were not uniform in regard to the question of shareholder or director liability made the business lawyer's job of advising a corporation operating across state lines very difficult. A noted New York business lawyer delivering a paper on corporate bonds in 1916 to The Association of the Bar of the City of New York identified this particular risk and opined:

> It is advisable always to include in the bond a waiver of liability of officers, directors and stockholders, even if at the time of the issue of the bond no such liability exists. Subsequent use or acceptance of statutory provisions of consolidation or amendment of charter or otherwise, may constitute an acceptance of all statutory burdens existing at the later date and may involve a personal liability not existing at the date or at the issuance of the bond. Indeed, comparatively recently the Supreme Court of the United States has held that a corporation formed in a State without stockholders' liability, but declared to be intended for business in a State with such liability, may by carrying on such business bring its members under the liability laws of the latter State. The better practice is to insert the waiver in the bond as well as in the indenture.[36]

33. Hohfeld, *supra* note 30, at 297; Blumberg, *supra* note 11, at 582, 615–16; Mahoney, *supra* note 27, at 885.

34. United States v. Stanford, 70 F. 346, 363 (9th Cir. 1895) (internal quotations omitted), *aff'd*, 161 U.S. 412 (1896).

35. *See* Note, *The "No Recourse" Clause in Corporate Bonds and Indentures*, 34 Colum. L. Rev. 107, 107 (1934); *see also* Preston v. Howell, 257 N.W. 415 (Iowa 1934); Cont'l Corp. v. Gowdy, 186 N.E. 244 (Mass. 1933).

36. Francis Lynde Stetson et al., Some Legal Phases of Corporate Financing, Reorganization and Regulation 17–18 (1917). The authors believe that the U.S. Supreme Court case to which Mr. Stetson was referring was most likely *Thomas v. Matthiessen*, 232 U.S. 221 (1914). In that case, a New York resident who acquired shares in a corporation formed under the laws of Arizona with a charter specifying that the purpose of the corporation was to build and operate a hotel in California was subject to California law imposing liability on corporate shareholders for the corporation's debts. For further authority, see *Pinney v. Nelson*, 183 U.S. 144 (1901), in which stockholders of a Colorado corporation formed to do business partly in California made themselves subject to California's direct stockholder liability law.

Consistent with this advice, a fairly typical "no recourse" clause in the early part of the 20th century read as follows:

> No recourse under or upon any obligation, covenant, or agreement of this indenture, or of any purchase-money bond or coupon, or because of the creation of any indebtedness hereby secured, shall be had against any incorporator, stockholder, officer, or director of the company or any successor corporation, either directly or through the company, by the enforcement of any assessment or by any legal or equitable proceeding by virtue of any statute or otherwise. This indenture and the purchase money bonds are solely corporate obligations, and no personal liability whatever shall attach to or be incurred by the incorporators, stockholders, officers, or directors of the company, or any successor corporation, or any of them, because of the incurring of the indebtedness hereby authorized, or under or by reason of any of the obligations, covenants, or agreements contained in this indenture, or in any of the purchase-money bonds or coupons, and any and all personal liability either at common law or in equity, or by statute or Constitution, of every such stockholder, officer, or director, is released and waived as a condition of and as part of the consideration for the execution of this indenture and the issue of the purchase-money bonds.[37]

The courts were fairly uniform in upholding the effectiveness of these clauses, at least to the extent that the liability from which the shareholders and directors sought to be exonerated was the liability imposed by statute for the contractual obligations of the corporate obligor.[38] Indeed, as noted by one early federal court decision regarding the standard "no recourse" clause:

> Such a clause is one quite familiar in bond issues, and unless used as a part of a scheme to defraud, it is not only not against public policy, but I think is a fair and proper protection with which stockholders have the right to surround themselves.
>
> The books are full of instances where some liability, of which no one thought at the time, arises thereafter when unexpected disaster overtakes an enterprise. The "no recourse" clause is designed to protect against the unexpected and uncontemplated.[39]

In most of these early cases, the effectiveness of the "no recourse" clause appears to have been determined solely upon the basis of freedom of contract principles without regard to equity.[40] As a 19th century court said in upholding the effec-

37. Small v. Sullivan, 157 N.E. 261, 264–65 (N.Y. 1927).

38. *See, e.g.*, Babbitt v. Read, 236 F. 42 (2d Cir. 1916); Rosoff v. Gilbert Transp. Co., 221 F. 972, 982–83 (D. Conn. 1915); Fid. Trust Co. v. Wash.-Or. Corp., 217 F. 588 (W.D. Wash. 1914); Peck v. Horst, 264 P.2d 888 (Kan. 1954); *Preston*, 257 N.W. at 415; Katz v. Dunn, 189 N.E. 54 (Mass. 1934); *Cont'l Corp.*, 186 N.E. at 244; Grady v. Graham, 116 P. 1098 (Wash. 1911); Hull v. Standard Coal & Iron Co., 11 Ohio Cir. Dec. 331 (Ohio Cir. 1900); Hardman v. Cincinnati & E. Ry. Co., 10 Ohio Dec. Reprint 67 (Ohio Ct. C.P. 1887); James C. Bonbright, *Shareholders' Defenses Against Liability to Creditors on Watered Stock*, 25 Colum. L. Rev. 408, 423 (1925); Note, *Corporations—Stockholders—Individual Liability to Corporation and Creditors—Protection from Creditor by No Recourse Clause*, 30 Harv. L. Rev. 395, 395–96 (1917); Note, *The "No Recourse" Clause in Corporate Bonds and Indentures*, 34 Colum. L. Rev. 107 (1934); Annotation, *Validity, Construction, and Effect of Clause in Obligation of Corporation that Is Issued Without Recourse*, 87 A.L.R. 1052 (1933), *supplemented by* 97 A.L.R. 1157 (1935); Annotation, *Validity of Provision in Contract with Corporation Waiving Liability of Stockholders*, 40 A.L.R. 371 (1926).

39. Babbitt v. Read, 215 F. 395, 418 (S.D.N.Y. 1914) (internal citations omitted), *aff'd*, 236 F. 42 (2d Cir. 1916).

40. *See, e.g.*, *Preston*, 257 N.W. at 423.

tiveness of an agreement not to seek recourse against stockholders, "the plaintiff could not strike at the members of that corporation in a court of equity through and by means of a transaction which bound him not to do so."[41] Moreover, the courts did not appear troubled by the fact that the liability that was primarily sought to be avoided by these contractual provisions was liability imposed by statute.[42] In most cases the courts were able to conclude that the statutes imposing liability on the shareholders and directors were made for the benefit of creditors and that there was, therefore, no public policy that prevented the creditor beneficiaries from waiving the benefit of those statutes.[43]

Efforts to use the standard "no recourse" provision to exonerate directors from "future fraudulent acts of the directors" in diverting funds from the corporation to themselves as stockholders, however, were uniformly unsuccessful in the early decisions of the courts considering these provisions.[44] Thus, for example, in *Small v. Sullivan*, the New York Court of Appeals, after reviewing the "no recourse" provision quoted above, said:

> Without attempting to state the meaning and extent of this "no recourse clause," we are confident of one thing, that it did not and could not cover the future fraudulent acts of the directors. The complaint, as we have indicated, alleges a consolidation conceived and executed in fraud, and for the willful and intentional purpose of procuring the assets and income of the corporations. The consolidation was long after the making of the trust agreement.
>
> The directors could not willfully and fraudulently destroy or convert the property held as security for these bonds, whether it was pledged to the trustee or was the general assets of the corporation, and then plead that they were protected by an agreement that they should not be liable for their acts. The agreement did not relate to such future acts.[45]

The threat being addressed in the 19th and early 20th centuries by our business lawyer forebears in using the standard "no recourse" clause, therefore, was primarily the risk of statutory imposition of liability on directors or stockholders for the contractual obligations incurred by the corporate obligor. However, the risk of statutorily imposed liability dissipated during the latter part of the

41. Brown v. E. Slate Co., 134 Mass. 590, 592 (1883). *Brown* involved an enforceable "oral" agreement not to seek recourse against shareholders for statutorily imposed liability. *Id.*

42. *See Cont'l Corp.*, 186 N.E. at 245; *Preston*, 257 N.W. at 417; *Katz*, 189 N.E. at 55.

43. *Preston*, 257 N.W. at 421–22; *Cont'l Corp.*, 186 N.E. at 249. But where the statute imposing liability on shareholders of a corporation was enacted specifically to "increase the care in the management of these corporations, by extending the liability of the stockholders so as to compel them to see that their agents managed the business with care, honesty and fidelity, and thus subserve the interests of the public and the state[,]" a "no recourse" clause was deemed ineffective because the statute was not designed solely to confer benefit on creditors that they could choose to waive if they so desired. Kreisser v. Ashtabula Gas Light Co., 14 Ohio Cir. Dec. 313, 1901 WL 1163, at *6 (Ohio Cir. 1901). For a more recent decision to the same effect, see *Schollmeyer v. Saxowsky*, 211 N.W.2d 377, 386 (N.D. 1973).

44. Bankers Trust Co. v. Hale & Kilburn Corp., 84 F.2d 401, 404 (2d Cir. 1936); Abercrombie v. United Light & Power Co., 7 F. Supp. 530, 543–45 (D. Md. 1934); Small v. Sullivan, 157 N.E. 261, 264 (N.Y. 1927); Downer v. Union Land Co., 129 N.W. 777, 779–80 (Minn. 1911).

45. *Small*, 157 N.E. at 265.

20th century, and the states instead began to recognize uniformly a statutory liability shield provided by incorporation. As a result, the liability risks that the historical "no recourse" clause was originally designed to avoid were largely assigned to the history vaults. And, as new threats from tort and piercing-the-veil theories emerged in the modern era there was a need to revisit this clause and adapt it more specifically to those emerging threats and to all entity-specific contracts, not just bond indentures. Except in the case of the private equity industry, however, it does not appear that business lawyers of the modern era have been as adept as their 19th and early 20th century counterparts in adopting a standard contractual provision to address the new threats to the officers, directors, and equity holders of the contracting entity in an entity-specific contract.

IV. Modern Principles of Corporate and Limited-Liability Entity Law

Having discussed the original purpose and use of the "no recourse against others" clause that originated in indentures from the 19th and early 20th centuries and continues to find its way into modern indentures, we now review corporate and limited-liability law as it exists today, as well as threats to limited liability that have emerged in the modern era.

A. General Principles of Modern Entity and Limited-Liability Law

For today's business lawyer, the corporation's legally distinct existence has four corollary principles[46] that appear to be almost universally recognized:

- corporations have the right to enter into contracts and enforce those contracts to the same extent as do individuals;[47]
- the property of each corporation is separate from the property of the corporation's owners (whether they are individuals or other corporations);[48]
- the property of the corporation cannot be subject to claims against, or used to satisfy the debts of, the corporation's owners (whether they are individuals or other corporations);[49] and
- the property of a corporation's owners (whether they are individuals or other corporations) cannot be subject to claims against, or used to satisfy the debts of, that corporation.[50]

46. *See* 3 William S. Holdsworth, A History of English Law 482 (1942).
47. *Id.*; Lyons-Thomas Hardware Co. v. Perry Stove Mfg. Co., 24 S.W. 16, 16–17 (Tex. 1893) (citing English law for the proposition that corporations have the same power to contract as natural persons).
48. Holdsworth, *supra* note 46, at 482; R.I. Hosp. Trust Co. v. Doughton, 270 U.S. 69, 81 (1926); Humphreys v. McKissock, 140 U.S. 304, 312 (1891).
49. Holdsworth, *supra* note 46, at 482; *Humphreys*, 140 U.S. at 312.
50. Holdsworth, *supra* note 46, at 482; *see also* West & Cargill, *supra* note 1, at 1059.

These basic principles appear to have been equally applied to all statutorily recognized limited-liability entities.[51]

In addition to these basic principles of limited-liability entity law, there are also several fundamental principles of contract law that impact contract making by limited-liability entities:

- a contract only imposes obligations on the persons who actually agreed to become parties to, or to otherwise guarantee obligations of a party to, that contract;[52]
- parties to a contract are generally free to include whatever terms they wish in their voluntarily made agreements provided they do not violate public policy;[53] and
- an agent for a disclosed principal—like an officer of a named corporate party—does not become personally liable on that contract merely by executing the contract on behalf of the disclosed principal as the named party to the contract, as long as the agent or officer clearly indicates his or her representative capacity in the signature block.[54]

B. Exceptions to Limited Liability

The accepted principles of corporate law that recognize the separateness of each limited-liability entity from its owners, directors, or officers, and the similarly recognized principles of contract law that limit liability under a contract to the named parties to that contract only, have in modern times become subject to some exceptions. Courts created these exceptions even though the statutes creating limited-liability regimes rarely have built-in statutory exceptions.[55] In the United States, the liability protection provided to a limited-liability entity's officers, equity owners, and directors in connection with an entity-specific contract has been subject to three broad categories of exceptions:

51. *See, e.g.*, Carter G. Bishop & Daniel S. Kleinberger, Limited Liability Companies: Tax and Business Law § 6.01 (2010) (analogizing principles of limited liability companies' distinct personhood to that of corporations); Del. Code Ann. tit. 6, § 18-106(c) (2005) (stating that an LLC has the power and authority to enter into contracts and other agreements).

52. *See* Johnson v. Coleman, 288 S.W.2d 348, 349 (Ky. 1956); 17(a) Am. Jur. 2d *Contracts* § 412 (1964).

53. *See, e.g.*, *In re* Prudential Ins. Co. of Am., 148 S.W.3d 124, 129 (Tex. 2004); Fox v. I-10, Ltd., 957 P.2d 1018, 1022 (Colo. 1998); *see also* Glenn D. West & W. Benton Lewis, *Contracting to Avoid Extra-Contractual Liability—Can Your Contractual Deal Ever Really Be the "Entire" Deal?*, 64 Bus. Law. 999 (2009); Natalie Smeltzer, Note, *Freedom to Contract in Texas—Enforceability of an "As Is" Clause in a Commercial Lease:* Gym-N-I Playgrounds, Inc. v. Snider, 61 SMU L. Rev. 509 (2008).

54. *See* Glenn D. West, *Protecting the Deal Professional from Personal Liability for Contract-Related Claims*, Weil, Gotshal & Manges LLP Private Equity Alert, Mar. 2006, at 5, 5–6, *available at* http://www.weil.com/wgm/cwgmhomep.nsf/Files/PEAMar06/$file/PEAMar06.pdf; Lee v. YES of Russellville, Inc., 784 So. 2d 1022, 1027 (Ala. 2000); 3 Am. Jur. 2d *Agency* § 291 (1962).

55. *See* David L. Cohen, *Theories of the Corporation and the Limited Liability Company: How Should Courts and Legislatures Articulate Rules for Piercing the Veil, Fiduciary Responsibility and Securities Regulation for the Limited Liability Company?*, 51 Okla. L. Rev. 427, 429 (1998).

- the various equitable theories that fall under the category of "piercing the veil";
- the various tort theories that impose liability on nonparties to a contract for their participation in some tortious activity related to entering into or performing that contract; and
- the few remaining statutory exceptions that provide third parties with a right to impose personal liability on directors, officers, or equity owners for a limited-liability entity's contractual obligations.[56]

1. Piercing the Veil

"Piercing the veil" is a concept that, as best as the authors are able to determine, appears to be premised on the faulty assumption that corporations are mere "artificial aggregations of individuals" that differ from general partnerships only on the basis of the statutory grant of limited liability.[57] Thus, according to this view, whenever justice demands, equity can intervene, that artificial aggregation can be ignored, and the individual owners can be held accountable. The piercing-the-veil theory appears to have been first popularized in a *Columbia Law Review* article published in 1912.[58] That theory, which has now evolved to include numerous other theories with different monikers, like "alter ego," "single business enterprise" (at least in some states), or the like, still predominates as the basis for the courts' willingness to ignore the entity and impose liability on the entity's owners.[59] To quote Maurice Wormser, the author of that article:

> When the conception of corporate entity is employed to defraud creditors, to evade an existing obligation, to circumvent a statute, to achieve or perpetuate monopoly, or to protect knavery or crime, the courts will draw aside the web of entity, will regard the corporate company as an association of live, up-and-doing, men and women shareholders, and will do justice between real persons.[60]

Suffice it to say that the problem with this broad approach to "draw[ing] aside the web of entity" to "do justice" is the modern courts' failure to articulate clearly the standards they employ in so doing.[61] Indeed, despite Professor Wormser's early

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56. *See, e.g.*, Tex. Tax Code Ann. § 171.255(a) (West 2008) (directors and officers can be held liable for any debt incurred by a corporation after the date the corporation's privileges have been forfeited for failing to file a report or pay a tax or penalty); Okla. Stat. Ann. tit. 68, § 1212 (West 2008) (trustees, directors, and officers can be held liable to the same extent as if they were partners for any debt incurred by the corporation with their knowledge, approval, and consent after the date that the corporation's right to do business has been forfeited).

57. *See* Horwitz, *supra* note 3, at 181.

58. I. Maurice Wormser, *Piercing the Veil of Corporate Entity*, 12 Colum. L. Rev. 496 (1912).

59. Veil-piercing concepts have also been applied to other statutorily recognized limited liability entities. *See, e.g.*, Natalie Smeltzer, Comment, *Piercing the Veil of a Texas Limited Liability Company: How Limited Is Member Liability?*, 61 SMU L. Rev. 1663 (2008).

60. Wormser, *supra* note 58, at 517.

61. *See* John H. Matheson, *The Limitations of Limited Liability: Lessons for Entrepreneurs (and Their Attorneys)*, 2 Minn. J. Bus. L. & Entrep. 1, 3 (2003); *see also* Phillip I. Blumberg, The Law of Corporate Groups: Procedural Problems in the Law of Parent and Subsidiary Corporations 8 (1983).

delineation of certain "bad acts" that would justify piercing, many modern courts allow a jury to decide the issue based on instructions that would permit piercing in virtually any parent-subsidiary relationship.[62] As a New York court recently stated:

> A corporate veil may be pierced, and an entity affiliated with a corporation may be liable for the corporation's breach of contract, either where the officers and employees of the affiliated entity exercise control over the daily operations of the corporation and act as the true prime movers behind the corporation's action, or on the theory that the affiliated entity conducts business through the corporation, which exists solely to serve the affiliated entity.[63]

Many business lawyers routinely represent clients who legitimately seek to form a limited-liability entity solely to insulate themselves from liability exposure arising from a new business venture.[64] Based on the standards articulated above, how are those business lawyers to advise their clients about the efficacy of the supposed limited liability provided by that newly formed entity?[65] Can they rely, at least in the case of contractual undertakings, on the fact that only the newly formed entity is a named party and there is no guarantee by the parent or individual owner? Recent surveys suggest otherwise.

A recent survey of reported appellate decisions across the United States reveals that the number of veil-piercing claims overall has increased significantly since the 1970s.[66] Moreover, another similar survey suggests that, at least in the parent-subsidiary context, courts are three times more likely to pierce the corporate veil in a contract case than in a tort case.[67] And, there are almost as many successful piercing cases overall in the contract context as there are in the tort context.[68] Indeed, although it has been said that a successful piercing-the-veil claim, "[l]ike lightning, . . . is rare, severe, and unprincipled,"[69] these surveys seem to suggest that, while the success of such claims may remain "severe" and "unprincipled," they are less "rare" than may have been thought.

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62. *See* John H. Matheson, *The Modern Law of Corporate Groups: An Empirical Study of Piercing the Corporate Veil in the Parent-Subsidiary Context*, 87 N.C. L. Rev. 1091, 1101 (2009).

63. Emposimato v. CIFC Acquisition Corp., No. 601728/2008, 2011 WL 833801, at *10 (N.Y. Sup. Ct. Mar. 7, 2011) (internal quotation and brackets omitted), *aff'd* 932 N.Y.S.2d 33 (App. Div. 2011).

64. Forming an entity specifically for the purpose of protecting its owners from personal liability is legally recognized as a legitimate purpose for forming such entity. *See* West & Cargill, *supra* note 1, at 1059–60; *see also* Gibraltar Sav. v. LDBrinkman Corp., 860 F.2d 1275, 1287 (5th Cir. 1988) ("Many wholly-owned subsidiaries and closely-held corporations are not factually distinct from their owners. Many are in fact controlled and operated in close concert with the interests of the owners, and do not have a distinct factual existence. . . . Such conduct is perfectly natural and proper and provides no basis for ignoring legal independence.").

65. *See* Douglas C. Michael, *To Know a Veil*, 26 J. Corp. L. 41, 42 (2000) ("What counsel does not wince when telling her client that liability is limited except in certain unspecified and unpredictable situations when it is not?"); West & Cargill, *supra* note 1, 1059.

66. Peter B. Oh, *Veil Piercing*, 89 Tex. L. Rev. 81, 107–10 (2010).

67. Matheson, *supra* note 62, at 1122.

68. Oh, *supra* note 66, at 127–28.

69. Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. Chi. L. Rev. 89, 89 (1985); *see also* Oh, *supra* note 66, at 83; David Millon, *The Still-Elusive Quest to Make Sense of Veil-Piercing*, 89 Tex. L. Rev. 15, 16 n.11 (2010).

To put all of these concerns into perspective, a recent study of reported appellate decisions found that approximately 50 percent of all piercing cases across the United States are successful.[70] In New York and Texas (both states with numerous cases in this area), approximately 21 percent and 23.5 percent, respectively, of all reported appellate decisions involving parent-subsidiary piercing claims have been successful.[71] Whatever this translates into in terms of the odds that a parent company will be insulated from contract-related liability incurred by its subsidiary, it is less than an ideal state of affairs for the business lawyer advising a corporate client.

2. Tort Intrusions into the Entity-Specific Contract

Piercing-the-veil claims are only one of the ways in which nonparty affiliates can be exposed to potential liability for the obligations of the specified entity party to an entity-specific contract. Another way nonparties can have liability for contracts entered into solely by an affiliate is through tort claims against those nonparty affiliates as a result of actions allegedly taken in connection with the negotiation, execution, or performance of the contract. The most important principles of tort law that can thus "contort"[72] the contractual relationship established by an otherwise entity-specific contract are

- Officers and other corporate representatives that participate in allegedly tortious conduct in connection with a contract can have direct personal liability, even if their activities were solely on behalf of the contracting entity and even if they carefully signed the contract only in a representative capacity.[73]
- Fraud and other tort-based claims against nonparty affiliates can be premised solely upon representations and warranties included in an entity-specific contract.[74]
- The term "fraud" encompasses more than intentional lies; it can also include reckless misrepresentation and even innocent misrepresentation (the so-called doctrine of "equitable fraud").[75]

70. Oh, *supra* note 66, at 89–90.

71. Matheson, *supra* note 62, at 1119. Remember, however, that the state or foreign country of incorporation may govern the law applicable to piercing claims, not the state where the claim is filed or the state selected as the governing law of the agreement. *See* Phillips v. United Heritage Corp., 319 S.W.3d 156, 161 (Tex. App. 2010). *But see* Oh, *supra* note 66, at 113–14. While most courts apply the "internal affairs" doctrine to veil-piercing claims, a few courts apply other conflicts theories, and thus, the state of incorporation may not necessarily govern veil-piercing claims. *See* Jennifer J. Johnson, *Risky Business: Choice-of-Law and the Unincorporated Entity*, 1 J. SMALL & EMERGING BUS. L. 249, 272–73, 273 n.91 (1997). The UK courts, for example, have a very limited view of piercing. A good summary of the English jurisprudence of piercing can be found in *Hasham v. Shayif*, [2008] EWHC 2380 (Fam), 2008 WL 5504532. *See also* Marc Moore, "*A Temple Built on Faulty Foundations*": *Piercing the Corporate Veil and the Legacy of* Salomon v. Salomon, 2006 J. BUS. L. 180, 180–203.

72. West & Lewis, *supra* note 53, at 1003 & n.23 (citing GRANT GILMORE, THE DEATH OF CONTRACT 98 (Roland K.L. Collins ed., 2d ed. 1995) (1974)).

73. *Id.* at 1017.

74. *Id.*

75. *Id.* at 1013–15; Francis H. Bohlen, *Misrepresentation as Deceit, Negligence, or Warranty*, 42 HARV. L. REV. 733 (1929); Page Keeton, *Fraud: The Necessity for an Intent to Deceive*, 5 UCLA L. REV. 583

- Negligent misrepresentation is a broad catch-all tort category that can cover almost every situation where a contractual representation that was designed as a contractual risk allocation device turns out to have been wrong.[76]
- While tort principles are imposed by law, not contractually consented to, most states provide a means for sophisticated parties to avoid contractually tort intrusions into their contractual relationship.[77]

A recent case that raises these "contort" principles and the corporate group's liability exposure for extra-contractual claims arising from an otherwise entity-specific contract is *DDJ Management, LLC v. Rhone Group L.L.C.*,[78] a New York Court of Appeals decision. After a corporate borrower failed to repay certain loans, the plaintiff lenders filed suit against the borrower and the borrower's controlling affiliates, two private equity firms.[79] Amongst other allegations, the lenders asserted that the borrowers presented them with false and misleading financial statements.[80] The lenders had obtained representations and warranties from the borrower in the loan agreement that nothing in the financial statements was materially misleading.[81] The case does not suggest that the borrower's controlling affiliates made any direct representations to the lenders. However, the lenders made fraud claims against all of the defendants based solely upon the representations set forth in the entity-specific loan agreement.[82]

Because a common law fraud claim requires a court to find that the recipient of a false representation justifiably relied on that representation, the issue the *DDJ Management* court addressed was whether a jury could find that the lenders justifiably relied on the alleged misrepresentations.[83] Holding that the lenders alleged facts from which a jury could find justifiable reliance, the court remanded the case to the lower court.[84] However, the relevant point for our discussion is the court's statement that a party to an agreement with a corporation is not unjustified in assuming that the corporation's controlling affiliates "would not knowingly cause a company they controlled to make false representations in a loan agree-

(1958); W. Page Keeton, *Actionable Misrepresentation: Legal Fault as a Requirement: II. Rescission*, 2 Okla. L. Rev. 56 (1949); W. Page Keeton, *Actionable Misrepresentation: Legal Fault as a Requirement: I. Some General Observations*, 1 Okla. L. Rev. 21 (1948); Everett B. Morris, *Liability for Innocent Misrepresentation*, 64 U.S. L. Rev. 121 (1930); Samuel Williston, *Liability for Honest Misrepresentation*, 24 Harv. L. Rev. 415 (1911). And, the next time someone tells you that "fraud" is a well-defined and understood term, consider the difficulty a recent English court had in coming to an accepted definition of "fraud" in the context of an agreement that released all claims "save in the case of fraud." *See* Cavell USA Inc. v. Seaton Ins. Co., [2009] EWCA (Civ) 1363 (Eng.).

76. West & Lewis, *supra* note 53, at 1015–16.

77. *Id.* at 1018–20.

78. 931 N.E.2d 87 (N.Y. 2010). This case was remanded to the lower court and a stipulation of discontinuance was filed on June 2, 2011. Stipulation of Discontinuance, DDJ Mgmt., LLC v. Rhone Grp. L.L.C., 931 N.E.2d 87 (N.Y. 2010) (No. 601.8321-2007).

79. *DDJ Mgmt.*, 931 N.E.2d at 89.

80. *Id.*

81. *Id.* at 90.

82. *Id.* at 89.

83. *Id.*

84. *Id.* at 93.

ment" entered into solely by that corporation.[85] While some of the alleged facts in *DDJ Management* were disturbing, the potential effect of this holding is that virtually any representation or warranty made in an entity-specific contract that later proves to be false could potentially be turned into a tort-based misrepresentation claim against nonparty affiliates that controlled such a contracting entity.

3. Statutory Impositions of Liability for the Benefit of Creditors

The third category of exceptions to the statutory liability seal is the few remaining instances where state statutes impose liability on corporate officers, directors, or shareholders for the benefit of counterparties to an entity-specific contract. Most business lawyers are familiar with illegal-dividend statutes that allow aggrieved corporate creditors harmed by a violation of these statutory proscriptions to seek recovery from the directors who authorized the offending dividends and ultimately from the shareholders who received such dividends.[86] Business lawyers who have counseled corporations facing insolvency are also familiar with the various state statutes that impose personal liability on officers and directors in specified circumstances for unpaid wage claims owed by the corporate employer.[87] In the authors' experience, however, business lawyers are not generally aware that there are some state statutes that actually convert a corporate contractual obligation into an officer's and director's personal obligation if the corporation incurs that contractual obligation after it fails to file a franchise tax report in, or pay franchise taxes to, the state where it was incorporated or qualified to do business.[88]

For example, an Oklahoma statute holds directors and officers liable to the same extent as if they were partners for any corporate debt incurred with their knowledge, approval, and consent after the date the corporation forfeits its right to do business.[89] Similarly, under a Texas statute, a corporation's directors and

85. *Id.*

86. For an example of an illegal-dividend statute, see Del. Code Ann. tit. 8, § 174 (2001) (Directors are jointly and severally liable to the corporation and its creditors for unlawful payment of dividend or unlawful stock purchase or redemption. Directors are entitled to be subrogated to the rights of the corporation against shareholders who receive such dividends with knowledge of their illegality.); *see also* N.Y. Bus. Corp. Law § 719 (McKinney 2003).

87. In New York, the ten largest shareholders of a privately held New York corporation are jointly and severally liable for any unpaid wage claims owing by that corporation. N.Y. Bus. Corp. Law § 630 (McKinney 2003). According to a recent New York court, this law only applies to New York corporations, not corporations that are formed in other states and are qualified to do business in New York. *See* Stuto v. Kerber, 888 N.Y.S.2d 872, 874 (Sup. Ct. 2009), *aff'd*, 910 N.Y.S.2d 215 (App. Div. 2010), *appeal granted*, 944 N.E.2d 657 (N.Y. 2011); *see also* 820 Ill. Comp. Stat. Ann. 115/13 (West 2008) (holding corporate officers liable for violations of state wage acts if the officer knowingly permits the corporation to violate such acts); Kan. Stat. Ann. § 44-323(b) (2000) (same); 43 Pa. Stat. Ann. §§ 260.2(a)–.11(a) (West 2009) (corporate officers are included within the definition of "employer" and thus are personally liable for the wages owed to workers).

88. *See* Glenn D. West & Susan Y. Chao, *Corporations*, 56 SMU L. Rev. 1395, 1399–1401 (2003); Glenn D. West, *Corporations*, 54 SMU L. Rev. 1221, 1222–25 (2001).

89. Okla. Stat. Ann. tit. 68, § 1212 (West 2008). Florida also has a similar statute under which directors and officers can be held personally liable for corporate debts incurred subsequent to the corporation's administrative dissolution. *See* Fla. Stat. Ann. § 607.1421(4) (West 2007).

officers are personally liable to the corporation's creditors for any corporate debt incurred after the date the corporation's annual franchise tax report or tax was due if its corporate privileges are subsequently forfeited.[90]

While these statutes may encourage a corporation to pay franchise taxes, they do not merely impose personal liability for the benefit of the state in order to collect unpaid taxes; rather they allow a creditor under an otherwise entity-specific contract to obtain an unbargained-for statutory guaranty from an officer or director unlucky enough to be at the helm when the corporation ultimately forfeits its charter for failure to file its franchise tax report or pay any franchise taxes due. This unbargained-for, statutory grant of personal liability in favor of the corporate creditor is similar to the now-extinct director and shareholder liability imposed by various state statutes in the 19th and early part of the 20th centuries. As explained above, these statutory grants of general personal liability for corporate debts were the exact issue the "no recourse against others" clause was originally designed to combat. Thus, while the authors are unaware of any modern case law addressing the contracting parties' ability to waive a statutory grant of personal liability, the overwhelming precedent from similar statutes imposing personal liability on directors and shareholders in the earlier part of the 20th century would certainly suggest that such waivers are permissible.[91]

V. Modern History of the "No Recourse Against Others" Clause

The historical "no recourse against others" clause was designed for a different set of circumstances than the circumstances that now confront business lawyers negotiating entity-specific contracts. While there remain a few limited circumstances involving statutorily imposed personal liability on officers and directors for corporate obligations created by entity-specific contracts, the biggest current threats to limited liability have developed from the common law. In the modern era, tort-based and equitable theories have greatly expanded the circumstances where corporate obligations can become the personal obligations of the authorizing directors, the benefiting shareholders, and the officers who negotiate and execute the agreements creating such obligations. How have business lawyers adapted the "no recourse against others" clause to meet these changed circumstances? The answer is: Not that well.[92]

90. Tex. Tax Code Ann. § 171.255(a) (West 2008); *see also* Taylor v. First Cmty. Credit Union, 316 S.W.3d 863, 866–70 (Tex. App. 2010) (holding a director of a Georgia corporation, authorized to do business in Texas, liable for debts of the corporation).

91. *See supra* notes 33–43 and accompanying text.

92. Change to boilerplate language in the market is a slow process, and as one commentator stated, such change "not only takes time, but also comes in stages—as we describe it, there is first an interpretive shock, then a lengthy period of adjustment, and only then a big shift in terms." Stephen J. Choi & G. Mitu Gulati, *Innovation in Boilerplate Contracts: An Empirical Examination of Sovereign Bonds*, 53 Emory L.J. 929, 937 (2004); *see also* Marcel Kahan & Michael Klausner, *Standardization and Innovation in Corporate Contracting (or "The Economics of Boilerplate")*, 83 Va. L. Rev. 713, 736 (1997) (suggesting that not only attorneys, but also underwriters, significantly influence changes in boilerplate language).

Throughout the modern era, the "no recourse against others" clause has largely remained unchanged, and its use has been largely confined to the bond indenture. Our review of the modern history of the "no recourse" clause breaks down into four basic segments. The first segment begins with the efforts of the American Bar Association to update and simplify the bond indenture. The second segment is a review of the series of Delaware cases that build on one another to determine the general meaning of the standard "no recourse" clause as commonly used in bond indentures, with little analysis of the actual words used in each of those clauses. The third segment is a series of cases from other jurisdictions that do not involve bond indentures, but that examine "no recourse" provisions that use language similar to the standard language in bond indentures, and in which the courts carefully parse the language of these clauses to determine their effectiveness with respect to each claim being asserted. The last segment is the private equity industry's development of a somewhat more modernized "no recourse" clause that provides guidance in developing a current provision for potential use in all entity-specific contracts.

A. The Model Bond Provisions

When the American Bar Foundation's Corporate Debt Financing Project completed its *Commentaries on Model Indenture Provisions* in 1965, it was noted that a "no recourse" provision remained a common feature of the majority of debentures then outstanding.[93] It was further noted, however, that "[t]his provision was excluded from the Model Provisions as unnecessary . . . [because] . . . [u]nder modern law, . . . the limited liability afforded by the corporate form is carefully protected."[94] Nevertheless, the *Commentaries* included a sample of a "no recourse" provision that, although deemed "unnecessary" for a corporate issuer, continues to find its way, with certain variations, into bond indentures today. That clause was remarkably similar to the clause in use during the early part of this century and quoted previously.[95] Yielding to "widespread practice," the "Model Simpli-

93. Am. Bar Found., Corporate Debt Financing Project, Commentaries on Model Debenture Indenture Provisions 1965, Model Debenture Indenture Provisions All Registered Issues 1967, and Certain Negotiable Provisions Which May Be Included in a Particular Incorporating Indenture 138–39 (1971) [hereinafter Commentaries].

94. *Id.* at 138; *see also* Marcel Kahan, *Rethinking Corporate Bonds: The Trade-Off Between Individual and Collective Rights*, 77 N.Y.U. L. Rev. 1040, 1065 (2002) ("[C]orporate officers rarely would face any personal liability to bondholders. Officers and directors are not signatories to the bond contract in their personal capacity and are thus not personally liable for breaches. Indeed, bond indentures specifically exclude personal liability of officers and directors.").

95. The sample clause provided in the *Commentaries* in 1965 read as follows:

> No recourse under or upon any obligation, covenant or agreement contained in this Indenture or any indenture supplement hereto, or in any Debenture or coupon, or for any claim based thereon or otherwise in respect thereof, shall be had against any incorporator, or against any past, present or future stockholder, director or officer, as such, of the Company or of any successor corporation, either directly or through the Company, whether by virtue of any constitution or statute or rule of law, or by the enforcement of any assessment or penalty or otherwise; it being expressly understood that this Indenture and the Debentures are solely corporate obligations, and that no such personal liability whatever shall attach to, or is or shall be incurred by, the incorporators, stockholders, directors or officers, as such, of the Company or any successor corporation, or any

fied Indenture" published by the *Business Lawyer* in 1983,[96] and again in 2000, as revised,[97] continued to include a "no recourse" provision, although in a much shorter version that simply stated that "[a]ll liability described in the Securities of any director, officer, employee or stockholder, as such, of the Company is waived and released."[98] The clauses in use currently tend to be longer and more closely aligned to the clause quoted above from earlier in this century, rather than the shorter versions proposed in 1983 and 2000.[99]

The *Commentaries* were written before the surge in piercing cases that began in the 1970s.[100] An examination of the case law since the *Commentaries* were written does not appear to support the assumption made in the *Commentaries* that "modern law" is sufficient without a contractual provision to protect "the limited liability afforded by the corporate form."[101] Moreover, the effectiveness of the continued use of the largely unchanged "no recourse" clause to protect contractually such limited liability has been less clear than many may have assumed. As far as the authors have been able to determine, this is the first article to examine the effect of these provisions in protecting officers, directors, and shareholders from the current liability threat arising from the entity-specific contract, i.e., the threat that a court will impose liability on shareholders, officers, and directors based on equitable and tort-based theories.

B. The Delaware Cases

The Delaware cases[102] that have considered "no recourse" clauses are disappointing for their uncharacteristic failure to examine fully the individual clauses

> of them, because of the creation of the indebtedness hereby authorized, or under or by reason of the obligations, covenants or agreements contained in this Indenture or in any of the Debentures or coupons or implied therefrom; and that any and all such personal liability, either at common law or in equity or by constitution or statute, of, and any and all such rights and claims against, every such incorporator, stockholder, director or officer, as such, are hereby expressly waived and released as a condition of, as a consideration for, the execution of this Indenture and the issue of such Debentures and coupons.

Commentaries, *supra* note 93, at 244–45. For a comparison to the clause in use earlier in this century, see *Small v. Sullivan*, 157 N.E. 261, 265 (N.Y. 1927).

96. Comm. on Devs. in Bus. Fin., ABA Section of Corp., Banking & Bus. Law, *Model Simplified Indenture*, 38 Bus. Law. 741 (1983) [hereinafter *Model Simplified Indenture*].

97. Ad Hoc Comm. for the Revision of the 1983 Simplified Indenture, *Revised Model Simplified Indenture*, 55 Bus. Law. 1115, 1223 (2000) [hereinafter *Revised Model Simplified Indenture*].

98. *Model Simplified Indenture, supra* note 96, at 772. The language in the 2000 Revision was slightly more detailed, stating, "A director, officer, employee or stockholder, as such, of the Company shall not have any liability for any obligations of the Company under the Securities or the Indenture or for any claim based on, in respect of or by reason of such obligations or their creation." *Revised Model Simplified Indenture, supra* note 97, at 1163.

99. *See, e.g.*, Cont'l Ill. Nat'l Bank & Trust Co. v. Hunt Int'l Res. Corp., Nos. 7888, 7844, 1987 WL 55826, at *4 (Del. Ch. Feb. 27, 1987); *see also* American Tire Distributors, Inc. Indenture, *infra* note 170.

100. *See* Oh, *supra* note 66, at 107.

101. Commentaries, *supra* note 93, at 138.

102. When we refer to "Delaware cases," we mean cases decided by both state and federal courts sitting in Delaware regardless of the law applied by those courts.

to determine whether the particular claim being asserted against a nonparty is, in fact, exonerated by that clause. Instead, there has been a series of cases, each building on and citing to one another, that stand for a general proposition: The standard "no recourse" clause only relieves nonparties of obligations arising from the contract itself, not extra-contractual tort-based or equitable claims (like veil piercing) that impose those contractual liabilities on the nonparty.

The problem with the Delaware cases begins with *Simons v. Cogan*.[103] In *Simons*, the Delaware Supreme Court reviewed a "no recourse" clause[104] in a bond indenture that the court said was "a standard provision that enjoys general acceptance."[105] According to the court, "[t]he meaning of the 'no recourse' provision is clear—it extends broad immunity to stockholders, directors and officers of the issuing corporation."[106] But, because the only claim being considered with regard to the effect of the "no recourse" provision was for breach of contract, the court said that the "no recourse" clause "limits liability for *breach of contract* to Knoll, the issuing corporation."[107] Therefore, the court granted the motion to dismiss the *contractual claim* against the individual defendants.[108]

Even though the *Simons* court only considered the effect of the "no recourse" clause in the context of a breach of contract claim, the language used by *Simons*—to limit the effect of the "no recourse" clause to contract claims—is a recurrent theme in the Delaware cases. Indeed, the few instances where the courts previously enforced these provisions only for breach of contract[109] became the basis for the other modern Delaware cases that, without any serious examination of the specific language of the particular provision, appeared to limit the effect of all "no recourse" provisions only to contract claims.[110] Admittedly, a review of many

103. 549 A.2d 300 (Del. 1988).

104. The "no recourse" clause that was the subject of *Simons* read as follows:

> No recourse shall be had for the payment of the principal of, premium, if any, or the interest on any Debentures, or any part thereof, or for any claim based thereon or otherwise in respect thereof, or of the indebtedness represented thereby, or upon any obligation, covenant or agreement of this Indenture, against any incorporator, or against any stockholder, officer or director, as such, past, present or future, of the Company, or of any predecessor or successor corporation, either directly or through the Company or any such predecessor or successor corporation, whether by virtue of any constitution, statute or rule of law, or by the enforcement of any assessment or penalty or otherwise; it being expressly agreed and understood that this Indenture and all the Debentures are solely corporate obligations, and that no personal liability whatsoever shall attach to, or be incurred by, any such incorporator, stockholder, officer or director, past, present or future of the Company . . . .

Id. at 305 n.2 (ellipses in original).

105. *Id.* at 305.

106. *Id.*

107. *Id.* (emphasis added).

108. *Id.*

109. *See, e.g.*, Mabon, Nugent & Co. v. Tex. Am. Energy Corp., 1988 WL 5492, at *3 (Del. Ch. Jan. 27, 1988).

110. *See id.* (holding that "plaintiffs' equitable claims [alter-ego and instrumentality] were not barred by the Indenture" based solely upon prior holdings that limited the effect of the "no recourse" clause being considered to contract claims); Geyer v. Ingersoll Publ'ns Co., 621 A.2d 784, 793 (Del. Ch. 1992) (Again, in another alter-ego claim, without any analysis of the actual clause involved and

of the specific clauses that were the subject of these cases reveals a basis upon which the court could have concluded that they did not cover claims that were not based upon the contractual rights created by the indenture itself. However, by seemingly declaring all such clauses as standard boilerplate having a standard meaning, when there were clear differences between some of the clauses, these Delaware courts have created unfortunate precedent.[111]

LaSalle National Bank v. Perelman,[112] a Delaware federal court decision applying New York law, is illustrative of the basic pattern of all the Delaware decisions. In *LaSalle*, the "no recourse" clause under consideration provided:

> A director, officer, employee or stockholder, *as such*, of the Company, Guarantor or the Trustee shall not have any liability for any obligations of the Company, the Guarantor or the Trustee under the Securities or this Indenture *or for any claim based on, in respect of or by reason of such obligation or their creation*. By accepting a Security, each Securityholder shall waive and release all such liability. The waiver and release shall be part of the consideration for the Issue of the Securities.[113]

The plaintiffs asserted claims against the officers, directors, and shareholders of the corporate issuers of certain bonds based on a variety of tort and equitable theories, including "piercing the corporate veil."[114] The court had previously granted summary judgment in favor of the defendants on all such claims.[115] But now, the court was considering the defendants' counterclaim that, by bringing the original allegations, the plaintiffs had violated the "no recourse" provisions in the bonds.[116] In response, the plaintiffs argued that the "no recourse" provisions were "limited to contract claims."[117] Because the plaintiffs' "claims were equitable or tortious in nature," the plaintiffs argued that their claims were "not subject to the no recourse provisions."[118] Relying upon the series of Delaware cases finding that standard "no recourse" clauses did not cover equitable claims, the court found that the "no recourse" clauses here did not cover any claims other than contract claims.[119] Remarkably, in reviewing the prior Delaware decisions that had held that equitable claims were not covered by a "no recourse" provision, the court dismissed the

seemingly relying upon *Mabon*, the court found that "the no recourse provision [did] not bar equitable claims."); U.S. Bank N. A. v. U.S. Timberlands Klamath Falls, L.L.C., 864 A.2d 930, 950–51 (Del. Ch. 2004) (non-contractual claims not covered by "no recourse" provision); *see also* Shenandoah Life Ins. Co. v. Valero Energy Corp., No. 9032, 1988 WL 63491, at *9 (Del. Ch. June 21, 1988) ("When the action is for breach of contract and not fraud in the inducement of the investment, provisions of this kind are effective to limit any liability that may be found to the issuer.").

111. Of course bond indentures are different from other contracts in that their "boilerplate provisions are . . . not the consequence of the relationship of particular borrowers and lenders and do not depend upon particularized intentions of the parties to an indenture." Sharon Steel Corp. v. Chase Manhattan Bank, N.A., 691 F.2d 1039, 1048 (2d Cir. 1982).

112. 141 F. Supp. 2d 451 (D. Del. 2001).

113. *Id.* at 456 (emphasis added).

114. *Id.* at 457.

115. LaSalle Nat'l Bank v. Perelman, 82 F. Supp. 2d 279 (D. Del. 2000) (applying New York law).

116. *LaSalle*, 141 F. Supp. 2d at 458.

117. *Id.*

118. *Id.*

119. *Id.* at 463.

particularized parsing of the language in the clause under consideration in *LaSalle*.[120] The court did so in part because a prior Delaware decision "in limiting the [no recourse] provision to contract claims," had not actually considered the specific language of the "no recourse" provision.[121]

Again, the "no recourse" clause at issue in *LaSalle* could have been clearer in its intent to waive any equitable piercing-the-veil claims, but the court's apparent dismissal of the possibility that such a clause could in fact waive such claims is unfortunate and, the authors believe, inaccurate. Indeed, a recent explanation of the Delaware authorities on this issue by the Delaware Court of Chancery in *U.S. Bank, N.A. v. U.S. Timberlands Klamath Falls, L.L.C.*, suggests that the appropriate limits on a "no recourse" clause are not "contractual claims" *per se*, but the commonly understood limits on all "no recourse" provisions, i.e., the public policy concern that a "no recourse" clause should not be utilized to exonerate shareholders, officers, or directors from future fraudulent behavior.[122] Equitable piercing-the-veil claims do not necessarily require a finding of actual fraudulent behavior in most states.[123] In fact, an equitable piercing claim is not even an independent cause of action against the nonparty owners of a corporate obligor under an entity-specific contract; rather "it is an assertion of facts and circumstances which will persuade the court to impose the corporate obligation

120. *Id.* at 461.

121. *Id.* The court had also found that the "no recourse" provision did not cover fraud claims in light of prior New York cases such as *Sullivan*. *Id.* at 460–61; *see supra* notes 44–45 and accompanying text.

122. 864 A.2d 930, 950–51 (Del. Ch. 2004) ("The reasoning behind these authorities is clear. The directors of an issuer should not be able to immunize themselves from a future breach of fiduciary duties or fraudulent conduct through a provision in the trust indenture. To allow the directors of an issuer to do so could encourage fraud by directors. Courts are quite reasonably reluctant to allow directors to preemptively exculpate themselves in this way."); *see also* Cont'l Ill. Nat'l Bank & Trust Co. v. Hunt Int'l Res. Corp., Nos. 7888, 7844, 1987 WL 55826, at *6 (Del. Ch. Feb. 27, 1987) ("[T]he 'no recourse' clause involved here, even if perhaps broader in scope than those involved in [prior cases], does not operate to bar Continental from maintaining an action for common law fraud."). *U.S. Timberlands* and *Continental* would appear to have been easily and better decided by reference to the principles enunciated in *Small v. Sullivan*, where the court held that a 'no recourse' clause could not exonerate intentionally fraudulent behavior committed after the bonds were issued. 157 N.E. 261, 266–67 (N.Y. 1927).

123. *See, e.g.*, William Passalacqua Builders, Inc. v. Resnick Developers S., Inc., 933 F.2d 131, 138–39 (2d Cir. 1991) (fraud need not be proven to pierce the corporate veil under New York law); United States v. Van Diviner, 822 F.2d 960, 964–65 (10th Cir. 1987) (applying Colorado law) (same); Riquelme Valdes v. Leisure Res. Grp., Inc., 810 F.2d 1345, 1352 (5th Cir. 1987) (showing of fraud not required to pierce veil); DeWitt Truck Brokers, Inc. v. W. Ray Flemming Fruit Co., 540 F.2d 681, 684 (4th Cir. 1976) ("plain fraud is not a necessary element in a finding to disregard the corporate entity"); Adam v. Mt. Pleasant Bank & Trust Co., 355 N.W.2d 868, 872 (Iowa 1984) ("[f]raud is not a prerequisite for piercing the corporate veil"); McLean v. Smith, 593 So. 2d 422, 426 (La. Ct. App. 1991) (the corporate veil can be pierced in the absence of fraud); CMS Energy Corp. v. Attorney Gen., 475 N.W.2d 451, 456 (Mich. Ct. App. 1991) ("Actual fraud need not be shown."); Paynesville Farmers Union Oil Co. v. Ever Ready Oil Co., 379 N.W.2d 186, 189 (Minn. Ct. App. 1985) (strict common law fraud is not required to pierce the veil); Amfac Mech. Supply Co. v. Federer, 645 P.2d 73, 74, 79 (Wyo. 1982) (reversing trial court decision that required fraud). By statute, Texas requires a showing of "actual fraud" to pierce the corporate veil in any contract-related claim. *See* West & Cargill, *supra* note 1, at 1061.

on its [nonparty] owners."[124] Accordingly, the authors believe that it is the actual *contractual* liability created by the entity-specific contract that is imposed on nonparty owners of the contracting entity through a veil-piercing claim.[125] As a result, that contractual liability should be clearly covered by most of the "no recourse" clauses found in bond indentures. Further, unless intentional fraud is the basis for a piercing claim, there should be no public policy to preclude enforcement of a "no recourse" clause to protect nonparty affiliates of the contracting parties from such piercing claims. Nonetheless, the Delaware cases have consistently held that equitable piercing-the-veil claims are not preempted by the standard "no recourse" clause.

If there is no longer any contractual liability imposed on officers, shareholders, or directors for a corporation's debts under the various state statutes,[126] and Delaware courts have refused thus far to acknowledge that the equitable imposition of such liability through a veil-piercing claim is covered by a standard "no recourse" clause, one may wonder what is the point of continuing to include that clause in bond indentures that might be subject to litigation in the Delaware courts. The answer is found in *In re Smurfit-Stone Container Corp*., a 2011 Delaware bankruptcy court decision that upheld the effectiveness of a standard "no recourse" clause to protect the sole U.S. member of a general partnership-like Canadian entity that had issued bonds.[127]

Smurfit-Stone Container Corp. involved a "no recourse" clause very similar to the "no recourse" clause under consideration in *LaSalle*.[128] Specifically, the "no recourse" provision prohibited:

> *any claim based [on the Notes] . . . or otherwise in respect thereof, . . . or because of the creation of any Indebtedness represented thereby,* . . . against any incorporator or against any past, present or future partner, stockholder, other equityholder, officer, director, employee or controlling person, *as such*, of [the issuing entity and the guarantor] . . . whether by virtue of any constitution, statute or rule of law, or by the enforcement of any assessment or penalty or otherwise.[129]

This case involved a claim against a U.S. parent corporation of a Canadian issuer where the plaintiff sought to impose liabilities on the U.S. parent based on a

124. Morris v. N.Y. State Dep't of Taxation & Fin., 623 N.E.2d 1157, 1160 (N.Y. 1993); *see also* Peacock v. Thomas, 516 U.S. 349, 354 (1996) ("[p]iercing the corporate veil is not itself an independent ERISA cause of action"); *In re* Transcolor Corp., 296 B.R. 343, 355 (Bankr. D. Md. 2003); Turner Murphy Co. v. Specialty Constructors, Inc., 659 So. 2d 1242, 1245 (Fla. Dist. Ct. App. 1995); Peetoom v. Swanson, 778 N.E.2d 291, 295 (Ill. App. Ct. 2002); Boles v. Nat'l Dev. Co., 175 S.W.3d 226, 251 (Tenn. Ct. App. 2005); Matthews Constr. Co. v. Rosen, 796 S.W.2d 692, 693 n.1 (Tex. 1990).

125. In a similar vein, the liability that general partners have for the obligations incurred by the partnership entity of which they are partners, although based on agency principles, is nevertheless contractual in nature. *See, e.g.*, Hoelting Enters. v. Nelson, 929 P.2d 183, 186 (Kan. Ct. App. 1996) ("The contractual nature of the action is not altered by the fact [that] Hoelting seeks to enforce the partnership contract against the partners personally.").

126. *But see supra* note 91 and accompanying text.

127. 444 B.R. 111, 111 (Bankr. D. Del. 2011).

128. *See id*. at 115; LaSalle Nat'l Bank v. Perelman, 141 F. Supp. 2d 451, 458–61 (D. Del. 2001).

129. *Smurfit-Stone*, 444 B.R. at 115 (emphasis added).

Canadian statute that required "every present and past member [of a company being wound up] . . . to contribute to the assets of the company to an amount sufficient for the payment of its debts and liabilities."[130] The Canadian subsidiary was an unlimited liability company whose principal liabilities consisted of notes issued under an Indenture governed by New York law.[131] Fortunately for the U.S. parent, the court deemed the "no recourse" clause effective to shut down the Canadian bankruptcy trustee's efforts to impose its Canadian subsidiary's contractual liabilities on the parent.[132] Thus, in *Smurfit-Stone Container Corp.*, we see the standard "no recourse" clause has the same effect it was originally designed to have: to limit statutorily imposed liabilities for entity-specific contractual obligations.

Based on these Delaware decisions, the standard "no recourse" clause currently in use in bond indentures could use some updating and expansion to cover more clearly some of the modern extra-contractual threats to limited liability. This is particularly true given the expectation of standardized meanings for all boilerplate provisions used in public bond indentures.[133]

C. Other Modern Cases

Unlike the Delaware cases, modern cases from other jurisdictions do not involve bond indentures and are more inclined to view each "no recourse" clause on its own terms. These cases do not reject out-of-hand the idea that a "no recourse" clause can waive certain tort-based and equitable claims. Indeed, the Hawaii Supreme Court has suggested that a clause that protects nonparties against tort-based claims arising out of a contractual arrangement "would be permissible as long as the agreement was not unconscionable and it was knowingly and willingly made, and . . . such a provision is valid to the extent it does not waive liability in situations of intentional or reckless conduct."[134] Similarly, in *Farnham v. Superior Court*, the California Court of Appeal held that a clause that limited liability solely to the corporate employer for all claims by the employee arising from an employment agreement (including a tort claim for defamation) was valid to exculpate the directors of the corporate employer from liability for such claims.[135] According to this court, such a clause "does not conflict with any public interest but is instead the result of a private, voluntary transaction in which [the employee] simply

130. *Id.* at 114.

131. *Id.* at 113, 117.

132. *Id.* at 117–18.

133. *See* Sharon Steel Corp. v. Chase Manhattan Bank, N.A., 691 F.2d 1039, 1048 (2d Cir. 1982); The Bank of N.Y. Mellon Trust Co. v. Liberty Media Corp., 29 A.3d 225, 241 (Del. 2011).

134. Laeroc Waikiki Parkside, LLC v. K.S.K. (Oahu) L.P., 166 P.3d 961, 984 (Haw. 2007).

135. 70 Cal. Rep. 2d 85, 91 (Ct. App. 1997). The "no recourse" clause in *Farnham* was denominated a "sole remedy" provision and it provided that all claims must be submitted to arbitration and that the corporate employee "waives any right he may have for a lawsuit for damages against any shareholder, director, officer, or employee of [the corporate employer] for any claim, cause of action, damage, cost, or expense, arising from, in connection with, or in relation to, the terms and provisions of this Agreement or any breach thereof." *Id.* at 86.

agreed to look to [the corporate employer] to shoulder a risk that might otherwise have fallen on its officers, directors and shareholders."[136]

Finch v. Southside Lincoln-Mercury, Inc.[137] is an example of a modern case where the court considered the meaning and the public policy implications of a "no recourse" clause in a context other than a standard bond indenture. In *Finch*, the landlords, the Finches, sued the directors of Southside Lincoln-Mercury, Inc., as well as its parent company, Ford Motor Company, following Southside's breach of certain lease agreements and its insolvency.[138] The claims asserted by the landlords included claims for breach of fiduciary duty, fraudulent transfer, and tortious interference.[139]

Ford had formed Southside as a newly created corporation to acquire certain dealership franchises from the landlords and to become the named lessee under the lease agreements covering the dealerships' sites.[140] Each lease contained a "no recourse" provision that stated that the landlord would not have any "recourse against any stockholder or director of Southside for payment of the rent, or performance of any other obligations of Southside, *or for any claim based on, or otherwise in respect of, this Lease* whether by virtue of any constitution, statute or rule of law."[141] The defendants argued that, in order to have any meaning at all, the "no recourse" clause had to cover claims involving "some theory other than breach of the lease."[142] After all, the clauses "would have been unnecessary and redundant if they were not intended to do more than simply reflect that Southside was the contracting entity."[143] The court did not believe the clause had the effect that the defendants suggested. According to the court:

> The Finches' claims of breach of fiduciary duties and fraudulent transfer against the directors and Ford are an attempt to recover money of which the Finches were allegedly wrongfully deprived because of allegedly tortious acts or other misconduct of the defendants, actions that were independent of and unrelated to Southside's breach of its obligations under the lease. Although success on their claims for breach of fiduciary duties or a fraudulent transfer may result in the Finches being able to recover amounts owed them under the leases with Southside, the fiduciary duties and statutory obligations on which these claims are based derive from sources *other* than the leases. Accordingly, we conclude that the Finches' allegation that Ford and the directors breached fiduciary duties and transferred assets in violation of [the state fraudulent transfer statute] are not "claim[s] based on, or otherwise in respect of" the lease.[144]

The court ultimately dismissed the breach of fiduciary duty claim (even though it was not precluded by the "no recourse" clause) because the Finches were suing

136. *Id.* at 91.
137. 685 N.W.2d 154 (Wis. Ct. App. 2004).
138. *Id.* at 157.
139. *Id.* at 158.
140. *Id.*
141. *Id.* at 161 (emphasis added) (internal quotations, ellipses, and brackets omitted).
142. *Id.* at 162.
143. *Id.*
144. *Id.*

only as creditors of Southside.[145] However, the court held that the "no recourse" clause covered the tortious interference claim:

> Unlike the breach of fiduciary duties and fraudulent transfer claims, . . . the tortious interference claim rests squarely on the Finches' contractual relationship with Southside. To establish the defendant's liability for tortious interference, the Finches must prove the existence of the contract and show precisely how Ford or the directors wrongfully caused Southside not to perform its contractual obligations.[146]

The court then held, however, that because tortious interference involved an "intentional tort," the "no recourse" clause was unenforceable on public policy grounds as to such claim.[147] In doing so, the court drew upon cases construing "exculpatory clauses" that attempted to relieve contracting parties from the consequences of their own "intentional or reckless conduct."[148]

A "no recourse" clause is different than an "exculpatory" clause because it exonerates nonparties from responsibility for the contracting parties' obligations and liabilities, rather than attempting to address the contracting parties' potential exposure in any way.[149] In fact, a "no recourse" clause is more akin to a "remedies limitation" provision in that it limits the remedies that are available to the contract counterparty by excluding access to nonparty affiliates of the other contracting party for any damages.[150] There is, however, a long public policy history against "no recourse" clauses exonerating nonparties from future intentionally harmful conduct.[151] But *Finch* did not suggest that parties could not waive other tort-based and equitable claims against nonparties through a carefully crafted "no recourse" clause. Further, at least in New York, the types of conduct that invalidate otherwise valid "remedies limitation" provisions based on applicable public policy concerns are generally only those of the most egregious nature.[152]

Hoosier Energy Rural Electric Cooperative, Inc. v. Amoco Tax Leasing IV Corp. is another modern case that is consistent with the idea that a "no recourse" provision is not necessarily limited to contract claims.[153] In *Hoosier*, the Seventh Circuit

145. *Id.* at 168.
146. *Id.* at 162.
147. *Id.* at 164.
148. *Id.* at 163–64.
149. *See* Sylvia v. Johnson, 691 N.E.2d 608, 609 n.2 (Mass. App. Ct. 1998).
150. *See* Farnham v. Superior Court, 70 Cal. Rep. 2d 85, 86 (Ct. App. 1997).
151. Small v. Sullivan, 157 N.E. 261, 264–65 (N.Y. 1927); *see also In re* Transcolor Corp., 296 B.R. 343, 373 (Bankr. D. Md. 2003) ("no recourse" provision held ineffective under Maryland law to exculpate individual owner of corporate issuer "in light of the fraud, misrepresentation, bad faith and intentional wrongdoing committed by one who asserts the clause as a defense"); *see generally* Thomas J. Hall, *The Public Policy Exception to the Enforceability of Damage Waiver Clauses*, METROPOLITAN CORP. COUNS., May 2008, at 23, *available at* http://www.metrocorpcounsel.com/pdf/2008/May/23.pdf.
152. *See* MyPlayCity, Inc. v. Conduit Ltd., No. 10 Civ. 1615(CM), 2011 WL 3273487, at *7 (S.D.N.Y. July 29, 2011) ("Even given restrictions on enforcing an exculpatory clause New York Courts set the bar quite high in placing misconduct within the exceptions, demanding nothing short of . . . a compelling demonstration of egregious intentional misbehavior evincing extreme culpability: malice, recklessness, deliberate or callous indifference to the rights of others, or an extensive pattern of wanton acts." (quoting Deutsche Lufthansa AG v. Boeing Co., No. 06 Civ. 7667(LBS), 2007 WL 403301, at *3 (S.D.N.Y. Feb. 2, 2007) (internal quotation omitted) (ellipses in original))).
153. 34 F.3d 1310 (7th Cir. 1994).

considered the effect of a "no recourse" clause very similar to the ones at issue in *LaSalle* and *Finch* and held it was effective to insulate the contracting subsidiary's corporate parent against a claim based on the non-contract theory of unjust enrichment.[154]

Amoco Tax Leasing had entered into a sale-leaseback transaction with Hoosier Energy to obtain certain tax benefits.[155] In connection with that transaction, Amoco Tax Leasing and Hoosier Energy entered into an agreement that obligated Amoco Tax Leasing to pay additional consideration to Hoosier Energy if the Internal Revenue Service published certain regulations or rulings that would allow Amoco Tax Leasing to make effective use of certain deductions over a five-year period rather than a fifteen-year period.[156] A dispute later arose as to whether the condition obligating Amoco Tax Leasing to pay the additional consideration had occurred, and Hoosier sued not only Amoco Tax Leasing but also Amoco Corporation, the ultimate parent of Amoco Tax Leasing and the entity that actually derived the benefit from the tax deductions.[157] The "no recourse" clause specifically prohibited "any claim based [on the obligation to make payment under the Agreement] . . . or otherwise in respect thereof or based on or in respect to this Agreement, against . . . any other Affiliate of Amoco."[158]

Unlike the courts in *LaSalle* and *Finch*, the Seventh Circuit had no difficulty concluding that a claim against Amoco Corporation, the ultimate parent of Amoco Tax Leasing, for unjust enrichment (as a result of the tax benefits received from the sale-leaseback transaction) was " 'based on' or otherwise 'in respect to' the sale-leaseback agreement."[159] In response to Hoosier Energy's assertion that the effect of the "no recourse" clause was to "merely prevent[] it from suing Amoco Corporation for breach of contract,"[160] the Seventh Circuit said that "there is no ambiguity as to whether this provision bars 'non-contract' claims—it clearly does."[161] Thus, the Seventh Circuit found that, because the "no recourse" clause "broadly applie[d] to any claim that is in any way 'based on' the sale-leaseback agreement or otherwise 'in respect to' the agreement," non-contract claims were covered and there was "no possibility that Hoosier Energy [could] maintain a cause of action against Amoco Corporation."[162]

D. The Private Equity Industry's Modern Adaptation of the "No Recourse" Clause

Insulating sponsors from the liabilities created by their acquisition vehicles and portfolio companies has long been a fundamental part of the structuring of pri-

154. *Id.* at 1310.
155. *Id.* at 1313.
156. *Id.*
157. *Id.* at 1314.
158. *Id.* at 1315.
159. *Id.*
160. *Id.* at 1316.
161. *Id.*
162. *Id.*

vate equity deals. In fact, prior to 2005, when the Sungard and Neiman Marcus transactions burst on the scene,[163] it was the rare sponsor who was willing to take on any kind of direct contractual obligation to the seller in a typical acquisition agreement.[164] Instead, the only buyer-related contractual obligor under a typical acquisition agreement was a newly formed company whose only assets were the debt commitments received from the proposed lenders and sometimes, but not always, a commitment from the sponsor to fund the equity required to close the deal if and when the debt commitments funded.[165] Typically, neither the debt nor equity commitments were directly enforceable by the seller. To bolster the liability protection provided by the use of newly created acquisition vehicles, many sponsors began insisting on including a "no recourse against others" provision in their acquisition agreements. The purpose of that provision was to expressly limit the seller's recourse for any breach of the acquisition agreement to the named buyer entity and to constrain the seller contractually from seeking to otherwise avoid the statutory liability shield and seek recourse directly against any affiliate of the buyer entity (i.e., the sponsor).[166]

Following the precedent established by the Sungard and Neiman Marcus transactions, however, sponsors began to take on limited, direct contractual liability to the seller in acquisition agreements, typically by guaranteeing the reverse break-up fees specified as the sole recourse for the buyer entity's failure to close the transaction.[167] As deals got even more competitive, some private equity sponsors began to agree to other obligations that further placed the sponsor in direct contractual privity with the seller.[168] Whatever actual recourse was specifically agreed to was always coupled with an express disclaimer of any other liability by virtue of an "exclusive remedy" provision and a "no recourse" clause that remained inviolate except as to the specifically agreed-upon recourse.[169] Unlike bond indentures,[170] the "no recourse" provisions used in the private equity industry have been somewhat modernized over time.

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163. *See* Sungard Data Sys. Inc., Agreement and Plan of Merger (Form 8-K) (Mar. 28, 2005); The Neiman Marcus Grp., Inc., Agreement and Plan of Merger (Form 8-K) (May 1, 2005).

164. *See* Glenn D. West & R. Jay Tabor, *Sungard and Neiman Marcus LBO Transactions—Increased Liability Risk to Private Equity Sponsors?*, Weil, Gotshal & Manges LLP Private Equity Alert, June 2005, at 1, *available at* http://www.weil.com/wgm/cwgmhomep.nsf/Files/PEAJun05/$file/PEAJun05.pdf.

165. *Id.* at 2–3; Steven M. Davidoff, *The Failure of Private Equity*, 82 S. Cal. L. Rev. 481, 491–93 (2009); David J. Sorkin & Eric M. Swedenburg, *Recent US Deals Depart from Traditional Financing (Supplement—The 2006 Guide to Private Equity and Venture Capital)*, Int'l Fin. L. Rev. (Jan. 1, 2006), http://www.iflr.com/Article/1984669/Channel/193438/Recent-US-deals-depart-from-traditional-financing.html.

166. *See* West & Tabor, *supra* note 164, at 3; Davidoff, *supra* note 165, at 496.

167. Davidoff, *supra* note 165, at 497.

168. *Id.* at 497–98.

169. *See* West & Tabor, *supra* note 164; Davidoff, *supra* note 165, at 534.

170. An example of a "no recourse" clause from a current indenture, Senior Subordinated Notes Indenture, Dated as of May 28, 2010, issued by American Tire Distributors, Inc. and affiliates follows:

> *No Recourse Against Others*. No past, present or future director, officer, employee, incorporator, member, partner or stockholder of the Guaranteeing Subsidiary (other than the Issuer and the Guarantors) shall have any liability for any obligations of the Issuer or the Guarantors (including the Guaranteeing Subsidiary) under the Notes, any Guarantees, the Indenture or this Supplemental

Business lawyers can find fairly typical examples of these provisions in the DynCorp International and Cerberus Capital transaction in 2010. The exclusive remedy provision in the Agreement and Plan of Merger provides:

> Notwithstanding anything to the contrary in this Agreement, . . . (i) the Company's rights pursuant to this Section 8.5 and the reimbursement and indemnification obligations of Parent under Sections 6.14(b)(iii) and 6.17 hereof or the guarantee thereof pursuant to the Limited Guarantee shall be the sole and exclusive remedy of the Company and its Subsidiaries against the former, current and future equity holders, controlling persons, directors, officers, employees, agents, Affiliates, members, managers, general or limited partners or assignees or Financing Sources of the Guarantor, Parent, Merger Sub or any former, current or future stockholder, controlling person, director, officer, employee, general or limited partner, member, manager, Affiliate, agent or assignee of any of the foregoing (each, a "*Related Party*") for any losses or damages suffered as a result of any breach of any representation, warranty, covenant or agreement made by Parent or Merger Sub in this Agreement or in any certificate or other document delivered in connection herewith or the failure of the Merger to be consummated, and upon payment of such amounts if and when due, none of the Guarantor, Parent, Merger Sub or any of their Related Parties shall have any further liability or obligation relating to or arising out of this Agreement or the transactions contemplated by this Agreement, except that Parent shall remain obligated with respect to the indemnification and reimbursement obligations of Parent contained in Sections 6.14(b)(iii) and 6.17. . . .[171]

This works together with the "no recourse" clause in the Limited Guarantee provided by the sponsor:

> *No Recourse*. Except as otherwise expressly provided herein, by its acceptance of the benefits of this Guarantee, the Company acknowledges and agrees that no Person other than the Guarantor has any obligations hereunder and that *no recourse shall be had hereunder, or for any claim based on, in respect of, or by reason of, such obligations or their creation, against, and no personal liability shall attach to*, the Guarantor or *any Non-Recourse Party*,[172] *whether by or through attempted piercing of the corporate veil*,

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> Indenture or for any claim based on, in respect of, or by reason of, such obligations or their creation. Each Holder by accepting Notes waives and releases all such liability. The waiver and release are part of the consideration for issuance of the Notes.

Am. Tire Distribs., Inc. & Am. Tire Distribs. Holdings, Inc., Senior Subordinated Notes Indenture (Form 8-K), at D-4 (June 6, 2010).

171. DynCorp Int'l Inc., Agreement and Plan of Merger (Form 8-K), Ex. 2.1, at 70 (Apr. 12, 2010).

172. Non-Recourse Party is defined in section 2(b) of the Guarantee as follows:

> The Company hereby covenants and agrees that it shall not institute, and shall cause its respective Affiliates not to institute, any proceeding or bring any other claim arising under, or in connection with, the Merger Agreement or the transactions contemplated thereby or otherwise relating thereto (including under the Equity Financing Letter) against (i) any of the former, current and future equity holders, controlling persons, directors, officers, employees, agents, Affiliates, members, managers, general or limited partners or assignees of the Guarantor, or (ii) any former, current or future stockholder, controlling person, director, officer, employee, general or limited partner, member, manager, Affiliate, agent or assignee of any of the foregoing (those persons and entities described in any of the foregoing clauses, and any of their respective successors or assigns, each being referred to as a "*Non-Recourse Party*"), except (x) for claims against the Guarantor, under this Guarantee or under the Equity Financing Letter issued by the Guarantor, or

> by or through a claim by or on behalf of the Company against the Guarantor or any Non-Recourse Party, by the enforcement of any assessment *or by any legal or equitable proceeding, by virtue of any statute, regulation or applicable Law, or otherwise*, except for the Company's rights against the Guarantor under this Guarantee, for Parents, Merger Sub's and the Company's rights under the Equity Financing Letter, and for the Company's rights against Parent or Merger Sub under the Merger Agreement. Recourse against the Guarantor pursuant to and expressly subject to the terms and conditions of this Guarantee and the Equity Financing Letter, and against Parent or Merger Sub under the Merger Agreement and the Equity Financing Letter, shall be the sole and exclusive remedies of the Company against the Guarantor, Parent, or Merger Sub in respect of any liabilities or obligations arising under, or in connection with, the Merger Agreement, the Equity Financing Letter or the transactions contemplated thereby.[173]

Interestingly, however, even in the private equity industry, these provisions do not find their way into bank loan agreements.[174] Moreover, while the "no recourse" provision is a "market" provision in virtually every private equity acquisition agreement, it has not found its way into any other corporate agreements generally. And, to the authors' knowledge, very few corporations routinely include such provisions in an effort to augment the limited-liability protection provided by the formation and use of a subsidiary to enter into an entity-specific contract.

> against Parent or Merger Sub under the Merger Agreement or (y) in the event that the Guarantor (I) consolidates with or merges with any other Person (an "*Acquiring Person*") and is not the continuing or surviving entity of such consolidation or merger or (II) sells, transfers, conveys or otherwise disposes of, including, without limitation, by the liquidation, dissolution or winding up of the Guarantor, all or a substantial portion of its properties and other assets to any Person (also an "*Acquiring Person*") such that the sum of the Guarantor's remaining net assets plus uncalled capital is less than the aggregate amount of payments required to be made by Parent or Merger Sub pursuant to the Merger Agreement, then, in each case, the Company may seek recourse from such Acquiring Person but only to the extent of the liability of the Guarantor hereunder.

DynCorp Int'l Inc., Guarantee (Form 8-K), Ex. 10.1, at 3 (Apr. 12, 2010).

173. *Id*. at 7 (emphasis added). The Cerberus Guarantee also includes the following provision that voids the Guarantee if certain claims are brought by the beneficiary of the Guarantee:

> Except as otherwise expressly provided herein, in the event that the Company or any of its Affiliates (i) asserts in any proceeding relating to this Guarantee that the provisions of Section 1 hereof limiting the Guarantor's liability under this Guarantee to the Maximum Amount or limiting the Guarantor's liability in respect of Third Party Payment Obligations to the Third Party Payment Maximum Amount or that the provisions of Section 2(b) or Section 8 hereof are illegal, invalid or unenforceable in whole or in part, or (ii) asserts any theory of liability against the Guarantor or any Non-Recourse Party with respect to the Merger Agreement or the transactions contemplated thereby, other than the liability of the Guarantor (but not any Non-Recourse Party) under this Guarantee, of Parent or Merger Sub under the Merger Agreement, or of the Guarantor, Parent or Merger Sub under the Equity Financing Letter, then (x) the Obligations of the Guarantor under this Guarantee shall terminate ab initio and be null and void and (y) if the Guarantor has previously made any payments under this Guarantee, the Guarantor shall be entitled to recover such payments from the Company.

Id. at 6.

174. One should note that the *DDJ Management* case involved a bank loan agreement executed by a portfolio company of two private equity firms. *See supra* notes 78–85 and accompanying text.

VI. Summary Reflections on the Current State of Limited-Liability Law and the Standard "No Recourse" Clause

In light of the foregoing discussion of the historical development of limited-liability law and the "no recourse" clause, certain propositions clearly emerge:

- In the era after parties began forming and utilizing the corporation, but before there was uniform statutory recognition of limited liability, parties actually contracted with each other for limited liability.
- With the exception of the private equity industry's use of the clause, the standard "no recourse" clause, originally found in indentures in the 19th and early 20th centuries and that has now migrated to certain other agreements, is not much different today than when it was originally conceived.
- The issue that the "no recourse" clause originally sought to address was primarily the statutorily imposed contractual liability of shareholders, officers, and directors of the contracting entity.
- Early drafters of the "no recourse" clause do not appear to have contemplated veil-piercing claims specifically. Nonetheless, the standard "no recourse" clause is certainly broad enough, in the authors' view, to encompass such claims because it was deliberately drafted to be "open-ended"[175] and to cover what one early case called "the unexpected and uncontemplated."[176] The authors also believe most practitioners assume that the standard "no recourse" clause found in indentures (without the improvements offered by the private equity industry in the M&A context) is designed primarily for that very purpose. The Delaware decisions, however, do not appear to support that view.
- Obviously, courts have some aversion to allowing a contractual clause to exculpate persons or entities from their own intentionally tortious acts. But equitable piercing-the-veil claims are not necessarily based on allegations of intentionally tortious acts.[177] Similarly, not all misrepresentation claims are based on intentional misrepresentation. However, all misrepresentation

175. William W. Bratton, Jr., *The Interpretation of Contracts Governing Corporate Debt Relationships*, 5 Cardozo L. Rev. 371, 384 (1984); *see also* Wilmington Trust Co. v. Tropicana Entm't, LLC, No. 3502-VCN, 2008 WL 555914, at *6 (Del. Ch. Feb. 29, 2008) ("Even with due respect for the principle that indentures (and their 'boilerplate' language in particular) should not be read as the source of some previously unrecognized 'implied' rights, the drafters of such documents bear the risk that acts or conduct not contemplated may fall squarely within the reach of the express and unambiguous language appearing in the document.").

176. Babbitt v. Read, 215 F. 395, 418 (S.D.N.Y. 1914), *aff'd*, 236 F. 42 (2d Cir. 1916); *see also* Garofalo v. St. Mary's Packing Co., 90 N.E.2d 292, 295 (Ill. App. Ct. 1950) ("'No recourse' means no access to, no return, no coming back upon, no assumption of any liability whatsoever, no looking to the party using the term for any reimbursement in case of loss, or damage, or failure of consideration in that which was the cause, the motive, the object, of the undertaking or contract.").

177. *See supra* notes 123–24 and accompanying text.

claims do require proof of reliance, and there is no reason a "no recourse" clause could not address and potentially eliminate claims against officers, directors, and equity holders of the contracting entities for both contractual and extra-contractual representations by disclaiming reliance upon such officers, directors, and equity holders with respect to any such representations.[178]

- Notwithstanding that limited liability is now the statutory norm for corporations and other frequently utilized limited-liability entities, the unpredictability in relying upon the statutory shield may suggest a need to return to the lessons of our business lawyer forebears, who used the contractual freedom provided by contract law to bargain for limited liability even when the statutes provided none.
- The cases reveal opportunities to plug holes in the standard "no recourse" clause. Plugging these holes should make it more difficult for disappointed counterparties to pierce the contracting entity and obtain recourse from persons with whom that counterparty did not contract. In addition, plugging these holes in a standard bond indenture will hopefully allow these provisions to accomplish what many thought they already did, notwithstanding the prior Delaware decisions to the contrary.
- With the exception of bond indentures from which the clause originated and in the private equity industry, there is no evidence of a widespread practice of including some kind of "no recourse" clause in corporate agreements generally to protect the integrity of an entity-specific contract.
- The private equity industry is the only arena where there has been any effort to update and adapt the "no recourse" clause to the modern limited-liability threats. Even in that arena, however, there is room for improvement.

VII. Conclusion: A Proposed New "No Recourse" Clause

It is a fair assumption that the standard boilerplate provisions with which most business lawyers are familiar did not just appear in contracts; instead, they were created by business lawyers over time in response to common law developments that required the contracting parties to clarify their intent through an express provision. For example, a "no third-party beneficiary" provision was not necessary in the 19th and early part of the 20th century because privity of contract was clearly established as the only means by which one could seek to enforce a contract.[179] If you were not a party to the contract, therefore, you could not enforce it.[180] But as the U.S. common law developed to recognize that there were certain third parties who were "intended beneficiaries" of the contractual relationship and who, therefore, should have rights under that contract even though they

178. *See* West & Lewis, *supra* note 53, at 999.
179. *See* Tina L. Stark, Negotiating and Drafting Contract Boilerplate 97–99 (2003).
180. *Id.* at 97.

were not parties thereto, business lawyers desiring to disclaim any such intent presumably began to see the need for a clause expressly disclaiming such intent. As a result, a "no third-party beneficiary" clause is now commonplace in modern agreements. Now the challenge is to make sure that when someone is an intended third-party beneficiary, that person is carved out from the now boilerplate "no third-party beneficiary" provision to avoid any conflict.[181] Such conflicts have developed due to the failure of many business lawyers to attend adequately to boilerplate generally.[182]

Unlike the "no third-party beneficiary" provision, the "no recourse" clause never became standard boilerplate except in the case of bond indentures. Of course, in the case of the "no recourse" clause, the issue is not disclaiming the intent to benefit nonparties to the contract, but disclaiming the imposition of liabilities arising from the relationship created by a contract on nonparties to that contract. The authors believe that the time has come to consider developing a "no third-party liability" provision that will become as common in entity-specific contracts as the standard boilerplate "no third-party beneficiary" provision.

Accordingly, borrowing from the historical "no recourse" clause created in the 19th and early 20th centuries and the private equity industry's attempts to modernize it, and taking into account the case law developments regarding the interpretation of the effectiveness of such clauses, the authors propose the following as a possible "boilerplate" provision to consider incorporating in all entity-specific contracts:

> *No Recourse Against Nonparty Affiliates*. All claims, obligations, liabilities, or causes of action (whether in contract or in tort, in law or in equity, or granted by statute) that may be based upon, in respect of, arise under, out or by reason of, be connected with, or relate in any manner to this Agreement, or the negotiation, execution, or performance of this Agreement (including any representation or warranty made in, in connection with, or as an inducement to, this Agreement), may be made only against (and are those solely of) the entities that are expressly identified as parties in the preamble to this Agreement ("*Contracting Parties*"). No Person who is not a Contracting Party, including without limitation any director, officer, employee, incorporator, member, partner, manager, stockholder, affiliate, agent, attorney, or representative of, and any financial advisor or lender to, any Contracting Party, or any director, officer, employee, incorporator, member, partner, manager, stockholder, affiliate, agent, attorney, or representative of, and any financial advisor or lender to, any of the foregoing ("*Nonparty Affiliates*"), shall have any liability (whether in contract or in tort, in law or in equity, or granted by statute) for any claims, causes of action, obligations, or liabilities arising under, out of, in connection with, or related in any manner to this Agreement or based on, in respect of, or by reason of this Agreement or its negotiation, execution, performance, or breach; and, to the maximum extent permitted by law, each Contracting Party hereby waives and releases all such liabilities, claims, causes of action, and obligations against any such Nonparty Affiliates. Without limiting the foregoing,

181. *See* Diamond Castle Partners IV PRC, L.P. v. IAC/Interactivecorp, 918 N.Y.S.2d 73, 74–75 (App. Div. 2011); Glen Banks, *Considering Indemnification to Non-Signatories in Acquisition*, N.Y. L.J. (Mar. 28, 2011), http://www.law.com/jsp/nylj/PubArticleNY.jsp?id=1202487944166&Considering_Indemnification_To_NonSignatories_in_Acquisition&slreturn=1&hbxlogin=1.

182. Stark, *supra* note 179, at 5.

> to the maximum extent permitted by law, (a) each Contracting Party hereby waives and releases any and all rights, claims, demands, or causes of action that may otherwise be available at law or in equity, or granted by statute, to avoid or disregard the entity form of a Contracting Party or otherwise impose liability of a Contracting Party on any Nonparty Affiliate, whether granted by statute or based on theories of equity, agency, control, instrumentality, alter ego, domination, sham, single business enterprise, piercing the veil, unfairness, undercapitalization, or otherwise; and (b) each Contracting Party disclaims any reliance upon any Nonparty Affiliates with respect to the performance of this Agreement or any representation or warranty made in, in connection with, or as an inducement to this Agreement.[183]

Do not forget to carve out this paragraph from the "no third-party beneficiary" provision because it is obviously intended to benefit and be enforceable by all nonparty affiliates. In addition, it may be appropriate to consider including an exception to the effect of this clause with regard to nonparty affiliates who participate in some deliberately fraudulent conduct after the contract's execution date that denies the counterparty the benefits of that contract.[184] As previously noted, public policy in many states would likely prevent enforcement of the provision in such circumstances in any event.

If it is a "fundamental principle of contract law . . . [that] parties must be able to confidently allocate risks and costs during their bargaining without fear that unanticipated liability may arise in the future,"[185] then that principle is violated when equitable and tort-based theories are permitted to intrude into an entity-specific contract and expose nonparty affiliates of the contracting parties to "that unanticipated liability." Moreover, if an entity-specific contract is truly intended only to be an obligation of the named contracting entities, adding a provision to clarify that intent should not be controversial, at least between sophisticated contracting parties. Further, the proliferation of equitable and tort-based claims challenging the integrity of the entity-specific contract suggests that some additional contractual constraint may be appropriate, even if some contend it should not be necessary. Therefore, the authors offer this clause to the current generation of business lawyers to supply or supplement what may indeed be missing or

183. This clause borrows from the work of our business lawyer forebears and attempts to plug holes that the case law indicates have developed. For early versions of this clause, see West & Lewis, *supra* note 53, at 1038; Glenn D. West & Sarah E. Stasny, *Corporations*, 58 SMU L. Rev. 719, 727 (2005). Many of the words used to describe the monikers and justifications that encompass the various "piercing-the-veil" theories are borrowed from Oh, *supra* note 66, at 83 n.7. The length of this clause is an effort to avoid the apparent lack of clarity in the existing "no recourse" provisions in circulation. *See* Victor v. Riklis, No. 91 Civ. 2897 (LJF), 1992 WL 122911, at *6 n.8 (S.D.N.Y. May 15, 1992) ("no recourse" clause held not to be "sufficiently unambiguous as to preclude [plaintiff's] claims against any non-issuer defendants").

184. While the authors could suggest a clause, we will leave this to the negotiating parties. Moreover, the authors believe that by limiting the effect of the waivers and releases set forth in this provision to "the maximum extent permitted by law," there is already a built-in exception for these purposes. These provisions work best when they are part of a comprehensive set of clauses designed to preserve the integrity of the contractual bargain. *See generally* West & Lewis, *supra* note 53.

185. Vanderbeek v. Vernon Corp., 50 P.3d 866, 871 (Colo. 2002); *see also* West & Lewis, *supra* note 53, at 1035.

ineffective boilerplate left us by our business lawyer forebears from a different era, addressing different threats than those now facing the owners of entity parties to an entity-specific contract. Deal dynamics and market forces, of course, will dictate the degree to which this offered clause will achieve the type of acceptance necessary for it to truly become boilerplate in all entity-specific contracts.

Author Biographies for The Business Lawyer, Volume 67, Issue 1, November 2012

Protecting the Integrity of the Entity Specific Contract: The "No Recourse Against Others Clause"—Missing or Ineffective Boilerplate?

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