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CORPORATIONS

by

Robert W. Hamilton*

THERE were major developments in several areas during the survey period. In addition to several significant decisions by Texas and federal courts, there were major legislative and administrative developments. Finally, the American Bar Association adopted a firm position with respect to a problem troubling attorneys involved in securities practice—the extent to which obligations owed to the public to prevent violations of the federal securities acts conflict with traditional duties owed to clients.

I. GENERAL CORPORATE DEVELOPMENTS

The Corporation as a Partner. One of the more interesting cases arising during the survey period is *Delaney v. Fidelity Lease Ltd.*¹ This case involved the rather common practice of creating a limited partnership with a corporation as the sole general partner and the investors in the venture assuming the role of limited partners. The justification for creating such a combination of forms is to secure for the investors partnership tax treatment combined with de facto limited liability.² Numerous so-called “tax shelters” utilize this combination of forms, with the hope that contemplated tax losses may be utilized by the limited partners to shield other income from taxation. In *Delaney* the limited partnership, Fidelity Lease Limited, was the lessee of a lease; the general partner was a corporation named Interlease Corporation; there were twenty-two limited partners, including three who were officers and directors of Interlease Corporation. The lease was clearly executed in the name of the limited partnership by Interlease acting as general partner; Interlease, in turn, was represented “by” its president (who was also one of the limited partners but who clearly signed as an agent of the corporation). The lessors proceeded to erect the required fast food service restaurant on the land, but the limited partnership breached its lease and never took possession. The lessor brought suit against the limited partnership, the corporate general partner, and the twenty-two limited partners. While the issue determinative of the case became whether the three limited

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1. 517 S.W.2d 420 (Tex. Civ. App.—El Paso 1974), *rev'd in part*, 526 S.W.2d 543 (Tex. 1975), *noted in* 29 Sw. L.J. 791 (1975).

2. The Internal Revenue Service will issue rulings that such hybrid organizations qualify for partnership status under certain circumstances. Rev. Proc. 72-13, 1972-1 CUM. BULL. 735; Rev. Proc. 74-17, 1974-1 CUM. BULL. 438. These circumstances include, among others, (1) the limited partners own not more than 20% of the stock of the general partner, (2) the corporate general partner's net worth is at least 15% of the contributions to the partnership (or \$250,000, whichever is the lesser), and (3) the general partner's share of each item of partnership income or loss is at least 1% of the total. These tests formally relate only to the availability of a ruling and not to the substantive tax issue of how the income of such a hybrid should be taxed.

partners who were also corporate officers and directors of the general partner were personally liable for the obligations of the limited partnership, views were also expressed on the broader question of the power of a corporation in Texas to become a general partner in a limited partnership.

In the Texas Court of Civil Appeals Justice Ward, Justice Osborn, and Chief Justice Preslar wrote three separate opinions. Justice Ward, writing the principal opinion, first concluded that it was permissible for a corporation to be a general partner, relying on both the earlier decision by the Supreme Court of Texas in *Port Arthur Trust Co. v. Muldrow*³ and the secretary of state's consistent practice of accepting for filing limited partnership certificates in which a corporation is the sole general partner.⁴ The justice then turned to the critical provision of the Texas Uniform Limited Partnership Act which states, "A limited partner shall not become liable as a general partner unless, in addition to the exercise of his rights and powers as a limited partner, he takes part in the control of the business."⁵ The justice acknowledged that "[i]f the language of this Statute is all controlling in importance" then the three limited partners who dominated the affairs of the corporate general partner would be personally liable. Nevertheless, he reached an opposite result by turning to "our basic notions of corporations."⁶ Pointing out that the plaintiff was not misled as to who was liable on the lease, and that the plaintiff voluntarily dealt with the limited partnership and the corporate general partner as such, the justice analogized the situation to contract cases where attempts are made to "pierce the corporate veil."⁷ The general position of the Texas courts in such cases is that in the absence of fraud or misleading conduct, a third person deals with a marginally capitalized corporation at his own risk, and that the use of a nominally capitalized corporation is often a device by which the risk of loss in a contractual arrangement is allocated by the parties.⁸ Finally, Justice Ward closed with this statement:

Admittedly, the decision in the case before us is not free from doubt. The logical reason to hold a limited partner to general liability under the control prohibition of the Statute is to prevent third parties from mistakenly assuming that the limited partner is a general partner and to rely on his general liability. However, it is hard to believe that a creditor would be deceived where he knowingly deals with a general

3. 155 Tex. 612, 291 S.W.2d 312 (1956).

4. This policy received indirect approval in an opinion of the Texas Attorney General. See TEX. ATT'Y GEN. OP. No. WW-191 (1957), *withdrawn on other grounds*, TEX. ATT'Y GEN. OP. No. WW-191-A (1958). It is also described in the "Filing Guide for Corporation and Limited Partnership Instruments" published by the secretary of state's office in 1974. See 19 R. HAMILTON, TEXAS PRACTICE: BUSINESS ORGANIZATIONS §§ 212, 255 (Supp. 1975) [hereinafter cited as HAMILTON].

5. TEX. REV. CIV. STAT. ANN. art. 6132a, § 8 (1970). The referenced section is § 7 of the Uniform Limited Partnership Act. Throughout the balance of this Article the Texas numeration will be used.

6. 517 S.W.2d at 423.

7. HAMILTON § 234.

8. *Id.* The justice was kind in quoting extensively from my *Texas Practice* treatise when developing this argument.

partner which is a corporation. That in itself is a creature specifically devised to limit liability.⁹

Justice Osborn concurred with Justice Ward on the rather narrow ground that there was no evidence showing that the defendants induced or misled the plaintiff into entering into the lease because of the defendants' individual or personal liability, and "[h]aving made their contract it is not for this Court to rewrite it and provide new and additional liabilities of parties who had originally limited their liability."¹⁰

Chief Justice Preslar dissented on several grounds.¹¹ In his view a corporation could not be a general partner under the Texas statutes. *Port Arthur Trust Co. v. Muldrow* was distinguished on the entirely correct ground that the court in that case held only that a corporation could be a *limited* partner in a partnership, and the chief justice believed that the pre-Uniform Partnership Act decisions holding that corporations could not be general partners continued to have vitality.¹² Furthermore, the chief justice argued that even under the Uniform Act a corporation could not be a general partner because section 21 of the Texas Uniform Limited Partnership Act refers to dissolution upon the retirement, death, or insanity of a general partner; none of these events, of course, normally happens to corporations.¹³

Secondly, Justice Preslar argued that the three limited partners who were corporate officers should be personally liable. He stated:

I find it difficult to separate their acts for they were at all times in the dual capacity of limited partners and officers of the corporation. Apparently the corporation had no function except to operate the limited partnership and . . . [defendants] were obligated to their other partners to so operate the corporation as to benefit the partnership. Each act was done then, not for the corporation, but for the partnership. Indirectly, if not directly, they were exercising control over the partnership. Truly 'the corporation function' was in this instance a fiction.¹⁴

Essentially, the problem was that the three limited partners were "wearing too many hats," and in fact were exercising control over the affairs of the limited partnership.

The opinion of the Texas Supreme Court is brief and to the point. Adopting the portion of Chief Justice Preslar's opinion quoted above, Justice Daniel stated that the limitation of section 8 of the Texas Limited Partnership Act "cannot be evaded merely by acting through a corporation."¹⁵ Furthermore, the absence of reliance is beside the point because the Texas Uniform Limited Partnership Act does not condition liability

9. 517 S.W.2d at 425.

10. *Id.* at 427 (Osborn, J., concurring).

11. *Id.* at 425 (Preslar, C.J., dissenting).

12. *See, e.g.,* *Luling Oil & Gas Co. v. Humble Oil & Ref. Co.*, 144 Tex. 475, 191 S.W.2d 716 (1945).

13. For a discussion of this argument see notes 23-25 *infra* and accompanying text.

14. 517 S.W.2d at 426-27.

15. 526 S.W.2d at 545.

under section 8 on the presence of reliance.¹⁶ As an alternative ground, the court referred to case law which holds that the corporate fiction will be ignored when it is used to "circumvent a statute" and "[t]hat is precisely the result here."¹⁷ Finally, the court specifically reserved decision on the question of whether a corporation could ever serve as a general partner in a limited partnership, thereby indicating that the question was still open under Texas law.¹⁸

The precise holding of the Texas Supreme Court in *Delaney* is that limited partners who control the affairs of the limited partnership by serving as officers or directors of a corporation which is the sole general partner lose the shield of limited liability. This will have an obvious impact on the planning of a number of ventures where the conduit-like tax treatment of partnerships is important. In some circumstances it may be possible to achieve substantially the same effect by forming a corporation rather than a limited partnership and electing subchapter S treatment if the number of investors is less than ten. Except for this alternative, no absolutely certain way appears to exist for the active manager of a venture to achieve the benefits of tax losses arising from the venture unless he or she is also willing to accept personal liability for possible losses. The active manager might consider putting the limited partnership interest in the name of a spouse or a corporation that elects subchapter S treatment. Also, persons active in the venture probably can avoid unlimited liability by not becoming limited partners; they may receive shares of the profits either through employment relationships with the corporation-general partner or through dividends paid on the shares issued by the corporation. Losses might be made available for tax purposes if the corporation can elect subchapter S treatment. Whether these more complicated combinations of business forms will work remains to be seen.

The specific reservation of the question of the power of Texas corporations to be general partners in limited partnerships seems procedurally correct, since the question was not covered by a point of error and did not require resolution to decide the case. The author of an *Annual Survey* article suffers no such procedural limitation on the expression of opinion. Justice Daniel, writing for the court, stated that the resolution of the question "depends upon the scope of the corporate charter . . . and upon whether we should extend our holding in *Port Arthur Trust Co. v. Muldrow* . . . to sanction corporations acting as general partners in a statutory limited partnership."¹⁹ This comment overlooks the statutory provisions granting specific powers to every corporation in the state, and the provisions of the Texas Uniform Partnership Act and Texas Uniform Limited Partnership Act. In 1973 article 2.02A of the Texas Business Corporation Act was amended to provide that each corporation shall have the power—"To be an organizer, partner, member, associate, or manager of any partnership,

16. *Id.*

17. *Id.* at 546.

18. *Id.*

19. *Id.*

joint venture, or other enterprise”²⁰ Further, section 6 of the Texas Uniform Partnership Act defines a “partnership” as “an association of two or more *persons* to carry on as co-owners a business for profit,”²¹ and section 2 of the same Act defines “persons” as including “individuals, partnerships, corporations, and other associations.”²² Given these definitions, it seems difficult to avoid the conclusion that at least since 1973 every Texas corporation has the power to be a general partner in a general partnership.²³ The question then becomes: Assuming that a corporation may be a general partner in a *general* partnership, is there any reason why it cannot be a general partner in a *limited* partnership? Section 2 of the Texas Uniform Limited Partnership Act defines “limited partnership” to be “a partnership formed by two (2) or more *persons* under the provisions of Section 3 of this Act, and having as members one (1) or more general partners and one (1) or more limited partners.”²⁴ A limited partnership is a sub genus of “partnerships” in which generally corporations may be general partners. This point is emphasized by section 6(2) of the Texas Uniform Partnership Act which states that “this Act shall apply to limited partnerships except in so far as the Statutes relating to such partnerships are inconsistent herewith.”²⁵

The foregoing seems to me to be almost totally persuasive.²⁶ There remain, however, two possible arguments that must be considered. The first is the argument made by Chief Justice Preslar, in the Texas Court of Civil Appeals, that a reading of section 21 of the Texas Uniform Limited Partnership Act shows that a corporation may not be a general partner because a limited partnership is dissolved upon the “retirement, death or insanity of a general partner,” and these are “things which do not happen to corporations.”²⁷ The justice also added that he would not construe “persons” to include corporations anywhere in the entire Act.²⁸ While this constructional argument has some force, I do not find it persuasive. The Uniform Limited Partnership Act was drafted in 1916,²⁹ almost contempo-

20. TEX. BUS. CORP. ACT ANN. art. 2.02A(18) (Supp. 1975-76).

21. TEX. REV. CIV. STAT. ANN. art. 6132b, § 6 (1970) (emphasis added).

22. *Id.* § 2 (emphasis added).

23. The lease in *Fidelity Lease* was executed prior to the effective date of the 1973 amendments, and, in fairness to Justice Daniel, the question under the pre-1973 statutes was considerably closer than it is today with respect to the statutes discussed in the text. See generally HAMILTON § 121.

24. TEX. REV. CIV. STAT. ANN. art. 6132a, § 2 (1970) (emphasis added).

25. *Id.* art. 6132b, § 6(2).

26. The discussion of this question in J. CRANE & A. BROMBERG, *LAW OF PARTNERSHIP* (1968) is also interesting. After talking about the basis of the common law rule that it is ultra vires for a corporation to be a partner since “partnership entails excessive delegation, perhaps even abdication of corporate management” by the directors, the authors state: “The rationale for the old rule fails, and partnerships are valid, if the corporate partner has all the powers of management. A fortiori this is true if the corporation is the sole general partner in a limited partnership.” *Id.* at 54. See also Tomlin v. Ceres Corp., 507 F.2d 642, 644 n.1 (5th Cir. 1975), where the court observes that the justification usually given for prohibiting a corporation from being a partner was that a partnership allows the corporation to be bound by the acts of other partners, thereby depriving the corporation’s directors of management of corporate affairs, but that this justification has no application when the corporation is the sole general partner. While this dictum purports to be a discussion of Texas law, there is no mention of the statutory provisions set forth earlier in the text.

27. 517 S.W.2d at 426.

28. *Id.*

29. J. CRANE & A. BROMBERG, *supra* note 26, at 13.

raneously with the first permanent federal income tax statute. It would be most unlikely that the draftsmen of the Uniform Limited Partnership Act ever dreamed there might be an advantage in creating a limited partnership with a corporate general partner, rather than by simply creating a corporation to conduct the business, with limited liability for all investors.³⁰

A second possible argument, based upon the policy behind the Limited Partnership Act, appears in the latter portion of Mr. Justice Daniel's opinion for the supreme court:

It is quite clear that there can be more than one general partner. Assuming that Interlease Corporation was a legal general partner, . . . this would not prevent Crombie, Kahn, and Sanders from taking part in the control of the business in their individual capacities as well as their corporate capacities. In no event should they be permitted to escape the statutory liability which would have devolved upon them if there had been no attempted interposition of the corporate shield against personal liability. *Otherwise, the statutory requirement of at least one general partner with general liability in a limited partnership can be circumvented or vitiated by limited partners operating the partnership through a corporation with minimum capitalization and therefore minimum liability.*³¹

The "policy" expressed in the italicized portion of the above quotation seems to me to be gossamer. A corporation with only nominal capitalization is nevertheless fully liable in theory for its debts in the same manner as an individual who is judgment proof is liable for his debts. Forming a limited partnership with a nominally capitalized corporation as the sole general partner is theoretically indistinguishable from forming a limited partnership with an insolvent individual as the sole general partner. A refinement of this argument suggests that the two situations are different; the corporate general partner permits one or more solvent limited partners "to have their cake and eat it too" since they combine control over the corporate decisions (and thereby control over the partnership decisions) with the preferred status of a limited partner. But the same refined argument can always be made when solvent persons decide to conduct a specific business in a nominally financed corporation. The public policy that apparently has evolved around this practice permits its use if the corporate form is not being used unfairly. Perhaps the same test should be used to evaluate the use of the corporate form in *Delaney*.

I do not mean to suggest that the questions involved in this case were easy, or that the Supreme Court of Texas was necessarily wrong. As the various opinions indicate, conflicting and inconsistent policies may be applied, and weighing them is a matter of judgment. My personal disagree-

30. On the other hand, it would have been likely for the draftsmen of the Uniform Partnership Act to consider the possibility that corporations might wish to participate as partners in a general partnership. Not only had the question been previously litigated—thereby demonstrating that corporations in fact sometimes did desire to be partners—but also corporations often engage in co-operative enterprises with other corporations and with individuals.

31. 526 S.W.2d at 546 (emphasis added).

ment may be expressed in the following two propositions: (1) the opinion of the supreme court gives the plaintiff a windfall in the sense that the defendants were personally liable on the lease obligation but the plaintiff did not rely on such personal liability when entering into the lease, and (2) while windfalls may sometimes be unavoidable to effectuate clearly defined statutory policies, I do not see that such a policy exists in these partnership statutes. Rather the policies relied on by the supreme court seem to be based on a literal and rather uncritical reading of the statutes.

Piercing the Corporate Veil. One area of corporation law that has been the subject of considerable discussion and some confusion is the extent to which the separate existence of the corporate entity should be ignored in a variety of different circumstances.³² In *Gentry v. Credit Plan Corp.*³³ the Supreme Court of Texas carefully analyzed the relationship between a parent corporation and its subsidiary, and, in an opinion that is likely to become the leading Texas precedent for the entire area, concluded that service of process on the subsidiary within the period of statute of limitations constituted service on the parent, since "as a matter of law, [the subsidiary is] the alter ego of [the parent]."³⁴

Before turning to the facts of the case before it, the court made the following introductory comment on general legal principles:

A subsidiary corporation will not be regarded as the alter ego of its parent merely because of stock ownership, a duplication of some or all of the directors or officers, or an exercise of the control that stock ownership gives to stockholders. On the other hand where management and operations are assimilated to the extent that the subsidiary is simply a name or conduit through which the parent conducts its business, the corporate fiction may be disregarded to prevent fraud or injustice. Unlike a suit for breach of contract, the plaintiff in a tort case does not have the burden of justifying a recovery against the parent when he willingly contracted with the subsidiary. The problem in such a case is essentially one of allocating the loss. It is not necessary to establish fraud, and the financial strength or weakness of the subsidiary is an important consideration.³⁵

This explicit statement by the Texas Supreme Court that torts cases involve different principles from contracts cases will probably be widely cited by lower courts. The case before the court involved an unreasonable collection efforts claim against a consumer financing company—a tort case.

In concluding that the subsidiary, Credit Plan Corporation, was the alter ego of the parent, Colonial Finance Company, the court carefully analyzed the relations between the two corporations and the manner in which the business was actually conducted. Colonial had a small galaxy of subsidi-

32. See Hamilton, *The Corporate Entity*, 49 TEXAS L. REV. 979 (1971). Illustrative of the continuing nature of this problem is the fact that every *Annual Survey of Texas Law of Corporations* has discussed one or more cases.

33. 528 S.W.2d 571 (Tex. 1975).

34. *Id.* at 575.

35. *Id.* at 573, citing, among other cases, *Bell Oil & Gas Co. v. Allied Chem. Corp.*, 431 S.W.2d 336 (Tex. 1968); *First Nat'l Bank v. Gamble*, 134 Tex. 121, 132 S.W.2d 100 (1939).

aries, all engaged in the business of making loans on the security of automobiles, furniture, and other property. Each subsidiary operated a separate office, usually in different cities. The same persons were officers and directors of Colonial and Credit Plan; they had the same corporate office and the same registered agent. The directors met at the same time and place. The managers for each office were selected by the president of Colonial. Credit Plan had issued 25,000 shares of stock—22,500 to Colonial and 2,500 to the manager. However, the manager signed a note which provided that if the manager resigned or retired Colonial had the right to purchase his stock at the original price. In the facts of the case before the court the manager had executed a promissory note for the purchase price of the stock; when he left, the note and stock certificate were cancelled and a new certificate issued in the name of the new manager, who signed a new note. The evidence also indicated that decisions with respect to compensation were made by Colonial for all its subsidiaries; a profit-sharing plan was proposed for the employees of "Colonial and its subsidiaries"; a bonus for the president of Colonial was established on the basis "of ten percent of the net income of each corporation, the bonus being allocated between the companies on the basis of their respective net incomes"; and employee insurance coverage was obtained in a single plan for parent and subsidiaries. The corporate records reflecting such decisions appeared in the minutes of Colonial's directors' meetings, in contrast to the minutes of the subsidiaries which reflected only bare formalities.

There were other indications that Colonial and its subsidiaries were all conducting a single business. Funds to finance the business were first obtained by the sale of Colonial's debentures; more recently a loan agreement was entered into with Walter E. Heller & Co., in which the paper generated by all the subsidiaries was acquired by Heller. Each subsidiary guaranteed repayment of all notes of all the subsidiaries. The loan proceeds were paid to another subsidiary, Kelley Acceptance Corporation, that made advances to Credit Plan and other operating subsidiaries. As the loans were repaid by the customers, the funds were paid to Kelley. Consolidated income tax returns were filed. Managers were routinely transferred from one office to another [*i.e.* from one corporation to another], and in one instance, two offices were combined.

Based on such evidence, the Texas Supreme Court concluded that "Credit Plan was operated and used by Colonial not as a separate entity but simply as a name under which Colonial did its business."³⁶ The court recognized, however, that it was not applying a simple or mechanical test. Rather, "[t]he purpose of the court in cases of this nature is to prevent use of the corporate entity as a cloak for fraud or illegality or to work an injustice, and that purpose should not be thwarted by adherence to any particular theory of liability. Colonial was in fact engaged in business in the name of Credit Plan, and we hold that they are to be regarded as identical for the purpose of determining whether the present suit is barred by limitation."³⁷

36. 528 S.W.2d at 575.

37. *Id.*

When all is said and done, in the torts area decisions must rest on notions of public policy and the willingness of courts to allow corporate businesses to utilize subsidiaries to immunize a portion of the business assets from claims of creditors. On the facts of the principal case there seems to be little doubt that Colonial should have been held liable for unreasonable collection efforts by the employees whether or not they technically were employees of Credit Plan since their activities were directed by Colonial; however, this was not the issue before the court. The issue was whether service of process on Credit Plan was also service on Colonial, since the statute of limitations had run and Colonial could not be made the subject of an independent suit. Presumably there is no question of "fair notice" in these closely intertwined parent/subsidiary relations; a question legitimately may be raised, however, whether a mistake by an attorney in failing to name Colonial originally should be ignored, since, unlike the next cases to be discussed, there does not appear to be any intentional confusion between the various corporations. Courts sometimes have stepped in where the names of the related corporations were very similar and confusion was apt to result, or where the corporation owning assets was using the name of a corporation without substantial assets and only the latter was served. We are not given any information by the court's opinion as to whether or not these factors were present in this case.

The problem of naming the wrong corporate defendant is particularly acute where a congeries of similarly named corporations exist, and it is difficult to determine which is the proper defendant. When the wrong defendant is named, a common defense practice has developed in Texas—file a general denial, wait until the statute of limitations has run, and then move for summary judgment on the ground that the defendant is not responsible for the plaintiff's injury.³⁸ Such cases were given a novel twist during the survey period. In *Continental Trailways, Inc. v. Hilland*³⁹ Hilland sued "Continental Trailways, Inc." for personal injuries suffered while leaving a "Continental Trailways" bus eighteen months earlier. It turns out that the bus was actually operated by "Continental Southern Lines, Inc.," and the corporation named as defendant, "Continental Trailways, Inc.," had no assets but had been formed solely to retain "Continental Trailways" as a trade name. A second case, *Cohen v. C.H. Leavell & Co.*,⁴⁰ involved similar facts: in a slip-and-fall case, the attorney for the plaintiff checked the filings under the assumed name statute for the true name of the entity operating under the name "Kern Plaza" (the shopping center where plaintiff's injuries occurred), and brought suit precisely in the form set forth in the certificate—C.H. Leavell & Co., Inc. After the statute of limitations had run it turned out that before the accident the property had been transferred

38. In addition to the cases discussed below, the same pattern appears in the Allright parking lot cases discussed in the last Annual Survey. See Hamilton, *Corporations, Annual Survey of Texas Law*, 29 Sw. L.J. 146, 157 (1975).

39. 516 S.W.2d 279 (Tex. Civ. App.—Houston [14th Dist.] 1974), *rev'd sub nom.* Continental Southern Lines, Inc. v. Hilland, 528 S.W.2d 828 (Tex. 1975).

40. 520 S.W.2d 793 (Tex. Civ. App.—El Paso 1975, no writ).

through several related corporations, and was no longer owned by "C.H. Leavell & Co., Inc." Both courts held that the plaintiff could amend its pleadings to substitute the name of the correct corporate defendant even though the statute of limitations had run, relying on rule 28 of the Texas Rules of Civil Procedure. This rule was amended in 1970 to read: "Any partnership, unincorporated association, private corporation, or individual doing business under an assumed name may sue or be sued in its partnership, assumed or common name for the purpose of enforcing for or against it a substantive right, but on a motion by any party or on the court's own motion the true name may be substituted."⁴¹ The argument for applying this provision to the case before it is succinctly stated by the Houston court in *Continental Trailways*:

In the case before this Court the appellee's original petition charged Continental Trailways, Inc. with negligently causing physical harm to the plaintiff. The petition gave the relevant information indicating the time, place and circumstances of the injury. It is undisputed that Continental Trailways, Inc. was nothing but the corporate vehicle for the trade name "Continental Trailways" under which the appellant Continental Southern Lines, Inc. did business. The effect of the first petition was suit against the entity doing business as 'Continental Trailways' which was responsible for the alleged injury. Sufficient facts were alleged by the appellee to enable Continental Trailways, Inc. to identify the responsible corporation as Continental Southern Lines, Inc., and the appellant did not show that any significant hardship would result from allowing the appellee to amend her petition and to proceed.

In amending Rule 28 the Supreme Court recognized the injustice which results from allowing the responsible corporate entity to lay behind the log until the statute of limitations has run. The ever increasing utilization of a single trade name by a multitude of independently owned corporations has made it necessary for courts to look behind the facade of corporate entities and to determine who is in the better position to ferret out the responsible party. Rule 28 allows the injured party to sue the obvious entity, the trade name, and thereby toll the statute pending the discovery of the particular corporate entity that should be sued. It ends the practice which allowed the shell company, such as Continental Trailways, Inc., to file a general denial and then to wait until the statute had run before disclaiming responsibility and pointing a finger at the corporation actually responsible.⁴²

The El Paso court's decision in *Cohen* followed shortly after *Continental Trailways* was decided, and relied primarily on that case.

The Supreme Court of Texas reversed the decision in *Continental Trailways*, but in doing so, opened up other avenues. The court held, alternatively, that the plaintiff could not take advantage of rule 28 because as a technical matter the named defendant was "*Continental Trailways, Inc.*," not "Continental Trailways" which was the assumed or common name, and that the amended rule 28 did not apply because the accident occurred long before

41. TEX. R. CIV. P. 28.

42. 516 S.W.2d at 281.

the amendment to rule 28 became effective. The court then added the following paragraphs describing the scope of its remand:

While there is no evidence here that the bus companies involved set about to deprive anyone of his or her rights, it is apparent that they have made a conscious effort to make it appear to the public and to their customers that they are 'Continental Trailways.' There is evidence that the corporations have the same agent for service; and it developed on the oral argument that they use the same attorneys in this area, at least in Houston. There was also some indication on oral argument that the service of citation may have actually been forwarded to Continental Southern Lines, Inc., but there was no indication as to when this may have occurred. The driver of the bus from which plaintiff fell, soon after the accident, filled out a report of the accident and sent it to his home office, the office of the 'real defendant,' *Continental Southern Lines, Inc.* From the above it might be inferred that its people became alerted and that its investigative people had prompt notice of the accident. Upon a retrial, the plaintiff will also have the opportunity to prove, if she can, that with knowledge of the facts of the accident, *Continental Southern Lines, Inc.*, caused an answer to be filed by *Continental Trailways, Inc.*, or acquiesced in such action. The record, however, was not fully developed; and there are only inferences, but no finding, that Continental Southern Lines, Inc., was actually notified and had a fair opportunity to defend itself before the period of limitations had run.

The primary purpose of a statute of limitations is to compel the exercise of a right within a reasonable time so that the opposite party has a fair opportunity to defend while witnesses are available and the evidence is fresh in their minds. While the plaintiff made a mistake in her original petition as to the defendant that should have been sued, it is our opinion that she should be given, under the circumstances here present, an opportunity to prove that the Continental Southern Lines, Inc., was cognizant of the facts, was not misled, or placed at a disadvantage in obtaining relevant evidence to defend the suit. . . .

If the substance of the facts set out above are found upon a new trial, it would be a misapplication of the statute of limitations to hold that the plaintiff's action was barred. Continental Southern would then have known or should have known that it would be the target if plaintiffs ever learned the new facts, and it had as much opportunity to prepare a defense as if it had been named a defendant in the original petition.⁴³

In the future it would be prudent for plaintiffs routinely to name "the common or assumed name" as well as the corporate defendant they believe to be responsible for the property causing the injury. It is a reasonable inference from the Texas Supreme Court's opinion that such plaintiffs may take advantage of the amended rule 28 in the event it turns out that they did not name the proper defendant. Also, the policy justification underlying the statute of limitations, as described by the supreme court's instructions on remand, would appear to have broad application, largely eliminating any need to rely on the "piercing the corporate veil" doctrine in these mistaken

43. 528 S.W.2d at 830-31.

defendant cases. The common defense tactic of "laying behind the log" appears to be effectively foreclosed in the future.

A questionable application of the piercing the corporate veil doctrine appears in the Fifth Circuit decision in *National Marine Service, Inc. v. C.J. Thibodeaux & Co.*,⁴⁴ at least if the rather sketchy facts set forth in the opinion do not omit additional relevant information. It appears that C.J. Thibodeaux and Company was a substantial business that desired to expand into the business of shipowning and operating. Thibodeaux hesitated to do so openly because it would then be competing directly with its regular customers. A tug, the "Grand Lake," was purchased by Thibodeaux in the name of a new corporation, The Prairie Company; after a couple of transfers, title to the boat ended up in the name of a partnership composed of Thibodeaux and two individuals. The boat was chartered to a nominally capitalized corporation, River Gulf Corporation, all the stock of which was owned by an employee of Thibodeaux. A posted notice in the wheelhouse stated that the owner of the vessel was The Prairie Company, and that the charterer, River Gulf, pursuant to the charter, did not have authority to incur liens upon the vessel. The "Grand Lake" put into plaintiff's, National Marine's, shipyard for repairs ordered by an employee of River Gulf. Upon failure to receive payment, plaintiff wrote the president of River Gulf, who replied that he was expecting an insurance payment and asked that a letter be sent from the plaintiff to the insurance carrier. When nothing further happened, the plaintiff filed suit against River Gulf and brought a libel against the "Grand Lake." The boat, however, had burned and sunk. Therefore, while the plaintiff obtained judgment against River Gulf by default, that judgment was valueless. Applying maritime law, the trial court concluded that Thibodeaux was liable for the repairs.⁴⁵ The court pointed out that the relationship between River Gulf, The Prairie Company, and Thibodeaux was not arm's-length and that the defendants were undoubtedly aware that repairs were being made. The court concluded, "the vessel owner was the real beneficiary" of the repairs, and defendants' "use of a paper corporation to accomplish a purpose they were unwilling to do openly, with the acknowledged need to keep the vessel in commerce" was sufficient to make them liable for the repairs.⁴⁶ The Fifth Circuit affirmed on the basis of the district court's analysis, adding that River Gulf was "an operating arm" of Thibodeaux and that River Gulf's corporate veil was "diaphanous."⁴⁷ In response to the argument that no fraud was shown, the court of appeals stated that fraud "is not a prerequisite to [piercing the corporate veil], especially where there is gross undercapitalization or complete domination of the corporate entity under scrutiny."⁴⁸

With respect, such justifications for the result are not satisfactory. The district court's analysis of the facts convincingly indicates that Thibodeaux's

44. 501 F.2d 940 (5th Cir. 1974).

45. *National Marine Serv., Inc. v. C.J. Thibodeaux & Co.*, 380 F. Supp. 1076 (S.D. Tex. 1973), *aff'd*, 501 F.2d 940 (5th Cir. 1974).

46. 380 F. Supp. at 1080.

47. 501 F.2d at 943.

48. *Id.* at 942.

responsible officers must have known of the repairs to the "Grand Lake" at the time they were made. Presumably, Thibodeaux thereby assented to the imposition of a lien despite the wheelhouse notice (of which plaintiff was apparently unaware). These facts also might justify a recovery in quasi-contract or unjust enrichment. However, the court's conclusion to "pierce the corporate veil" because the relationship between River Gulf and Prairie Company was not at arm's length (which also seems irrefutable since valuable property was turned over to a nominally-capitalized corporation without consideration) is hard to justify. So far as the plaintiff is concerned, nearly \$20,000 of repairs were made on a vessel without making investigation into its ownership or asking who was to pay for the repairs. The plaintiff was unaware of the defendants' interest in the vessel until after suit was begun.⁴⁹ Why would a shipyard do this? I assume the explanation lies in plaintiff's reliance on either the availability of insurance or its power to impose a lien on the vessel, which obviously was worth much more than the cost of the repairs. To permit recovery against the defendants seems to give the plaintiff a windfall that is not justified on the reasoning of the courts.

The concept of the separate existence of a corporation can have an unexpected bite. In *Mendenhall v. Fleming Co.*⁵⁰ two shareholders, the owners of all the stock in a corporation operating two food stores, brought suit for violation of the antitrust laws against the corporation's lessor and supplier of groceries. In essence, the complaint stated that the restrictive agreements imposed by the defendants violated the antitrust laws and materially reduced the value of the plaintiff's stock. This was evidenced, the plaintiffs argued, by the difference between two offers made by third parties for the stock, one free of the restrictive agreements (which fell through when the defendants refused to relinquish their rights under the agreements) and the other, smaller offer, subject to the restrictive agreements, which the plaintiffs accepted.

Relying on two earlier holdings,⁵¹ the Fifth Circuit held that the plaintiffs lacked standing to pursue the antitrust violations since the claim belonged to the corporation as an entity, rather than the shareholders personally.⁵² The economic harm to the plaintiffs was "indirect to and duplicative of" the corporation's right of action.⁵³ While this analysis makes sense as an abstract matter of corporate principle, it is not without some difficulty. Since the purchasers of all the corporate stock presumably paid fair value for it, a suit by the corporation itself might be met with the argument that under equitable principles the corporation should be viewed as representing the purchasers, and to permit corporate recovery would give the purchasers a windfall.⁵⁴

49. *Id.* As indicated above, a default judgment had been obtained against River Gulf, and only after that judgment proved uncollectable did plaintiff learn that defendants might be liable for the repairs.

50. 504 F.2d 879 (5th Cir. 1974).

51. *Martens v. Barrett*, 245 F.2d 844 (5th Cir. 1957); *Peter v. Western Newspaper Union*, 200 F.2d 867 (5th Cir. 1953).

52. 504 F.2d at 881-82.

53. *Id.* at 881.

54. This argument could be predicated on the United States Supreme Court decision

Authority of Officers. The authority of a president of a corporation to act with directoral approval continues to create problems for Texas courts. The general position taken by the courts is that a president has no actual or apparent authority to bind the corporation merely because of his position.⁵⁵ Such authority, however, may be found in statutes, bylaws, or appropriate actions taken by directors, including implied authorization and ratification. In one recent case, *Ennis Business Forms, Inc. v. Todd*,⁵⁶ the president of a corporation agreed that if an employee would remain on the job, \$200 per month would be set aside to be paid to him after the termination of his employment. The employee in question had been ineligible to participate in the corporation's retirement plan when first employed by the corporation. The promise allegedly was made, when the plaintiff was sixty-nine years old, in connection with an increase in the plaintiff's salary dictated by the fact that a much younger man was being employed at a higher salary than the plaintiff's.⁵⁷ The court concluded that the president was authorized to make such a promise on two grounds. First, it relied on the bylaws of the corporation which authorized the president to be "the chief administrative officer of the corporation" and gave him the power to enter into "other contracts of the corporation in the ordinary course of the business of the company."⁵⁸ Second, the court relied upon prior practice within the corporation, whereby the president had established salaries for a number of employees, without objection by the board, and had granted raises when people threatened to leave the employment of the corporation. The president testified he did not believe that this particular promise was significantly different from promises for increased compensation made to those other employees. This prior practice would justify an inference that the board had impliedly authorized such promises. On the other hand, in *Siboney Corp. v. Dresser Industries, Inc.*,⁵⁹ a contracts case, the court refused to hold a parent corporation (Siboney) liable for the debts of a subsidiary where it was shown that each corporation had different officers and the parent exercised no control over the subsidiary's routine business transactions. The subsidiary was not formed or operated for any illegal, improper, or fraudulent purpose, the court argued, and there were no representations, statements, or guarantees by the parent. The most difficult facts from the defendant's standpoint were that the business of the subsidiary at one time had been operated as a division of the parent, and the merchandise sold by the plaintiff on open account was billed as follows:

in *Bangor Punta Operations, Inc. v. Bangor & Arroostook R.R.*, 417 U.S. 703 (1974), although the case is distinguishable since the corporation in *Bangor* was suing the former owner of its stock rather than third persons.

55. See HAMILTON § 585.

56. 523 S.W.2d 83 (Tex. Civ. App.—Waco 1975, no writ).

57. The court did not find it necessary to consider whether the promise to pay what was in essence a pension was ordinary or extraordinary. For a thoughtful discussion of the authority to make such promises and distinguishing them from promises of lifetime employment (usually considered extraordinary in nature) see *Lee v. Jenkins Bros.*, 268 F.2d 357 (2d Cir.), cert. denied, 361 U.S. 913 (1959).

58. 523 S.W.2d at 86.

59. 521 S.W.2d 639 (Tex. Civ. App.—Houston [1st Dist.] 1975, writ ref'd n.r.e.).

COMPRESSION INCORPORATED
A DIVISION OF SIBONEY CORP. DBA
LEWIS HERNANDEZ CO.
11036 OLD KATY ROAD
HOUSTON, TEXAS

The court held that this did not establish actual or apparent authority on the part of the subsidiary to bind the parent. Even though this information "generally came from the customer," the court pointed out there was no evidence that Siboney authorized or permitted the subsidiary to represent itself as a division of Siboney.

In still another case⁶⁰ the plaintiff advanced between \$16,000 and \$18,000 to a corporation through the corporate president. These amounts were actually received, retained, and used by the corporation without authorization of the board of directors. When the board learned that the checks had been received, it recognized these loans on the basis of a report of an auditor. The court held that the corporation could not deny liability because the board of directors had "ratified" the transactions. The same case also involved a check given by the plaintiff to a wholly-owned subsidiary of the corporation. The court concluded that the defendant was liable for this obligation also, since it so "dominated" the subsidiary corporation "that the ultimate benefits went to the parent corporation."⁶¹ It is unclear what theory the court adopted when it made these rather ambiguous statements. The conclusions seem reasonable under a theory of unjust enrichment.⁶²

Because of the unsatisfactory nature of the case law in most states with respect to the authority of corporate officers and directors, the practice is widespread in Texas and elsewhere of requiring the corporation to supply a certified copy of a resolution of its board of directors authorizing the specific transaction. Of course as a practical matter, in many closely held corporations directors rarely or never meet. Business decisions are made by the shareholders—the real parties in interest—and corporate formalities are ignored. In many instances certified copies of resolutions are supplied even though no meetings were held. This is usually felt to be irrelevant, however, on the theory that certification of corporate records is within the secretary's express authority and the corporation is estopped to deny the validity of the certification.⁶³ This view is strongly supported by a case arising within the survey period. In *Diamond Paint Co. v. Embry*⁶⁴ the court rejected an

60. *Beef Indus., Inc. v. Bruer*, 516 S.W.2d 716 (Tex. Civ. App.—Amarillo 1974, no writ).

61. *Id.* at 721.

62. *See also* *Acoustical Screens in Color, Inc. v. T.C. Lordon Co.*, 524 S.W.2d 346 (Tex. Civ. App.—Dallas 1975, writ ref'd n.r.e.), where the court permitted a person contributing money to a corporation in contemplation of acquiring stock in that corporation to recover it back on the theory of money had and received when the agreement on the purchase of the stock fell through. In such cases several possible theories authorizing recovery may be available.

63. HAMILTON § 583. Indeed, on this theory it is a serious mistake to delve further than the certificate since to do so may uncover information that will destroy the estoppel.

64. 525 S.W.2d 529 (Tex. Civ. App.—Houston [14th Dist.] 1975, writ ref'd n.r.e.).

argument that the execution of a corporate guarantee of the indebtedness of another was unauthorized on the ground that a certified resolution authorizing the officer to execute the guarantee was binding on the corporation. The court stated:

This resolution is attacked . . . as hearsay. We agree with appellees' contention that the resolution is not hearsay as it was an operative act of the corporation creating express authority. . . . Latner (the Secretary of the Corporation) had the actual authority to certify copies of Board resolutions. It is elementary that a corporation is estopped from denying the representations of an agent made within the scope of authority. . . . As [the corporation] is estopped to deny the representation by Latner (its secretary) in the certificate, there was express authority for the execution of the guaranty.⁶⁵

While most commentators had stated that this was the Texas law, it is heartening to have a square judicial holding to this effect.

Officer Liability for Corporate Obligations. As described in the last *Annual Survey*, it is important for corporate officers to execute corporate documents in such a form as to indicate they are acting as agents and not personally.⁶⁶ Such executions usually involve transactions not reviewed by an attorney. Two such cases arose during the current survey period. In *Tomlin v. Ceres Corp.*⁶⁷ the court held the following form of execution to be ambiguous:

Dated: 10th of November, 1966

[Signature of Mitchell T. Curtis]

Mitchell T. Curtis

Mitchell T. Curtis & Co., Inc.

President

315 Montgomery St.

San Francisco, Calif.

Attest: *Melvin H. Brown*

Melvin H. Brown, Asst. Secy.⁶⁸

Since it was ambiguous, the court permitted parol testimony to be introduced as to the intention of the parties; the trial judge chose to believe that only a corporate execution was intended, a finding which could not be held to be clearly erroneous.

In a similar case arising in state court⁶⁹ a contract to remodel a house stated in the body of the contract that the contractor was "Peachtree Builders, Inc." in conspicuous, large print. However, in the space for the signature, the President of Peachtree Builders, R.D. Robertson, signed his own name on a line above the word "Contractor." The name "Peachtree Builders, Inc." did not appear either above or below the signature nor was there any indication that Robertson was signing as agent rather than as

65. *Id.* at 534.

66. Hamilton, *supra* note 38, at 153-54.

67. 507 F.2d 642 (5th Cir. 1975).

68. *Id.* at 645.

69. Robertson v. Bland, 517 S.W.2d 676 (Tex. Civ. App.—Houston [1st Dist.] 1974, writ *dism'd w.o.j.*).

principal. The trial court concluded that the contract was ambiguous, admitted parol testimony as to the parties' intention, and held Robertson personally liable. In a debatable decision, the court of civil appeals reversed, holding that the trial court's finding was against the great weight of the evidence, that the contract purported to be that of the corporation, and that there was no showing that Robertson had pledged his own responsibility or personally guaranteed the performance by the corporation. It is clear from the facts set forth in the court's opinion that there was little respect for the legal distinction between Robertson and his corporation. For example, Robertson was introduced as the "contractor" and when asked about a credit check on "Peachtree Builders" one of the plaintiffs responded that the Better Business Bureau "did not give us any adverse comment about Mr. Robertson."⁷⁰ In such circumstances, the decision of the trier of fact would seem to be supportable no matter which way it comes out. The court of civil appeals seemed to give undue weight to a printed reference in the body of the contract as to the identity of the "Contractor" despite the fact that the form of execution strongly suggests that an individual liability may have been contemplated.

The Saga of Salgo. *Salgo v. Matthews*,⁷¹ discussed at length in an earlier article,⁷² involved an unusual proxy fight in 1972 apparently controlled solely by state law. In that case the trial court had found for the "non-management" faction and had issued a permanent injunction in their favor. Apparently, the order was not stayed since the corporation was turned over to that faction. The court of civil appeals found basically in favor of the "management" faction, overturned the permanent injunction and rendered a judgment "dismissing the action and restoring the parties to the status existing when the suit was filed."⁷³ However, the successful attorney learned that it was one thing to win in the court of civil appeals and quite a different thing to effectuate the victory by resuming control of the corporation.

The attorney first filed a "motion to enforce mandate" in the trial court, seeking an order to enjoin the "non-management" faction from refusing to relinquish the positions on the board of directors. When the trial court refused he sought mandamus,⁷⁴ but lost because the 1972 meeting had never been completed and, thus, it was premature simply to order the "management" candidates for director to be elected. The attorney then tried again: He asked that the pre-meeting board of directors be restored to control so that they could cause the meeting to be completed. The "non-management" faction defended on the ground that the request was moot: After the mandate had been handed down in the original appeal, they had secretly and without notice to the plaintiff or his attorney completed the election, and lo and

70. *Id.* at 679.

71. 497 S.W.2d 620 (Tex. Civ. App.—Dallas 1973, writ ref'd n.r.e.).

72. Lebowitz, *Recent Developments in Texas Corporation Law—Part I*, 28 Sw. L.J. 641, 684-92 (1975).

73. 497 S.W.2d at 631.

74. *Salgo v. Hoffman*, 515 S.W.2d 756 (Tex. Civ. App.—Dallas 1974, no writ).

behold, the "non-management" faction had won after all, thereby mooting the request to restore the pre-meeting directors. This rather brazen defense was unexpectedly successful,⁷⁵ the court arguing that the original order was "negative" not affirmative, that the "management" faction could not get such relief because the plaintiff had not "proved" that an attempt to restore the former board would have been unsuccessful, and because essential parties were absent—the members of the pre-meeting board and the members of the board supposedly elected by the "non-management" faction after they obtained control of the corporation in compliance with the earlier court mandate. All of this was too much for Justice Williams:

I must respectfully dissent. This litigation has traversed a long and rocky road and it is high time that it should be brought to an end. I can easily share the frustration of the petitioners Salgo, et al, when they hear the majority of this court tell them that we cannot order the trial court to do that which is necessary to be done in order to enforce our original decree. In our original judgment, . . . we specifically, clearly and unequivocally said that the contention made by Salgo, et al, was correct and that the injunction which had been issued by the trial court was void and should be vacated. But we did not stop there. We also decreed in plain and unequivocal language that 'judgment is here rendered dismissing the action and restoring the parties to the status existing when the suit was filed.' Again, we did not stop with such statement. In our mandate directed to the trial court we directed such court to issue such writs and processes as would be necessary to carry out and enforce the judgment of this court. Now, after properly asking the trial court to do what we had said ought to be done and to restore the parties to the same status that existed at the time the erroneous injunction was issued, and being denied such relief, Salgo seeks relief from us asking that we do nothing more than to undo that which the trial court should not have done in the first place. In reply to this plea the majority has now, for the first time, said that we cannot grant the relief sought because our original judgment was negative and not affirmative. Faced with this situation I can join with Salgo, et al, and with the prophet Jeremiah in lamenting: 'Is there no balm in Gilead?'"⁷⁶

While the enforcement of a court order is a question of procedure rather than substantive corporation law, it is important to recognize the tremendous advantage that control of the corporate machinery gives. For example, in this case there were original proxies and ballots cast at a meeting in 1972; these papers are totally in the control of the "non-management" faction, and indeed their continued physical existence is a matter of judgment for that faction. To this writer, at least, the court of civil appeals did not seem to appreciate the difficulty of ousting entrenched management or the fact that time is an ally of those in control who continue to enjoy the fruits of that control. Apparently, the only remedy the victorious faction has, as a result of the refusal of the court to enforce that victory, is the institution of another independent law suit, naming all the former and putative directors as parties,

75. *Salgo v. Hoffman*, 521 S.W.2d 922 (Tex. Civ. App.—Dallas 1975, no writ).

76. *Id.* at 928 (Williams, J., dissenting).

in an effort to restore the former board. If the mootness defense can be overcome (which is probably likely given the secret nature of the alleged meeting), the ballots can be counted (if they still exist) and the victorious faction will be restored to control. Given inevitable appeals and delays, it is possible that the victorious faction will be installed in another year or so. Obviously, there is not much "balm" in the Texas court of civil appeals in Dallas.

Corporate Guaranties of the Indebtedness of Others. As has been described in earlier *Annual Surveys* and other sources,⁷⁷ before 1973 the Texas law with respect to the enforceability of corporate guarantees of the indebtedness of others was unsatisfactory. In 1973 the state legislature passed statutes dealing with the enforceability of corporate guarantees, broadly validating them.⁷⁸ In *Diamond Paint Co. v. Embry*⁷⁹ the court largely straightened out the pre-1973 uncertainties in this area in a satisfactory manner. First the court held that a corporate guarantee of the indebtedness of another was not "illegal." In reaching this conclusion, the court relied on the *Whitten* case⁸⁰ as indicating that corporate guarantees were at most ultra vires. The court stated that the 1973 amendment, while hardly conclusive, "is indicative of the trend of public policy from 1963 to the present to increasingly sanction corporate guaranties and to ease restriction against them."⁸¹ Further, the court held that even if the guarantee were ultra vires, article 2.04 of the Texas Business Corporation Act precludes the corporation from attacking the guarantee on that basis.⁸² Finally the court was faced with the claim by the sole shareholder of the guaranteeing corporation that it had the right to enjoin the guarantee under article 2.04B(1), which permits the defense of ultra vires to be asserted:

(1) In a proceeding by a shareholder against the corporation to enjoin the doing of any act or acts or the transfer of real or personal property by or to the corporation. If the unauthorized act or transfer sought to be enjoined is being, or is to be, performed or made pursuant to any contract to which the corporation is a party, the court may, if all of the parties to the contract are parties to the proceeding and if it deems the same to be equitable, set aside and enjoin the performance of such contract, and in so doing may allow to the corporation or to the other parties to the contract, as the case may be, compensation for the loss or damage sustained by either of them which may result

77. The history and development of this troublesome problem is described in Lebowitz, *supra* note 72, at 655-62. See also HAMILTON § 360.

78. This legislation took the form of an amendment to TEX. REV. CIV. STAT. ANN. art. 1302-2.06 (Supp. 1975-76), and is discussed in Lebowitz, *supra* note 72, at 655-62.

79. 525 S.W.2d 529 (Tex. Civ. App.—Houston [14th Dist.] 1975, writ ref'd n.r.e.).

80. 397 S.W.2d 415 (Tex. 1965).

81. 525 S.W.2d at 535.

82. TEX. BUS. CORP. ACT ANN. art 2.04 (1956) provides in part that ultra vires may not be asserted to invalidate an "act of a corporation" or "a conveyance or transfer of real or personal property to or by a corporation" except in three specified circumstances: (1) a shareholder proceeding to enjoin a corporate action; (2) a corporate proceeding or shareholder derivative suit against officers or directors for exceeding their authority; and (3) an attorney general proceeding either to dissolve the corporation, enjoin the transaction of unauthorized business, or enforce divestment of property held or acquired contrary to law. See HAMILTON § 352.

from the action of the court in setting aside and enjoining the performance of such contract, but anticipated profits to be derived from the performance of the contract shall not be awarded by the court as a part of loss or damage sustained.⁸³

The court concluded that the trial court had not abused its discretion in refusing to grant an injunction under this provision. The court pointed out that the shareholder had become such after the guarantee had been issued and that "undoubtedly" the shareholder's officers and directors were aware of the existence of the guarantee before purchasing the company. The court further pointed out that the shareholder's officers and directors, while they may have been "only haphazardly" informed about the guarantee, had made no investigation and had elected to ignore the matter. Under these circumstances, the court intimated, not only was the refusal to grant an injunction not arbitrary, but a decision to grant an injunction would have been improper.

If other courts follow the approach taken by the court in this case, many of the doubts, uncertainties, and concerns expressed about the status of the Texas law of corporate guaranties prior to 1973 will be resolved.

Attorneys' Fees in Shareholder Litigation. A continuing problem in shareholder litigation—both derivative and class—is whether a successful shareholder-plaintiff may recover his attorneys' fees from the corporation or from other defendants. There is no problem if there is a statute or an agreement authorizing the award of such fees; typically, however, there is not, and the issue comes down to whether the benefit conferred on non-plaintiff shareholders and the corporation is sufficiently great to justify charging that benefit with a reasonable attorney's fee. The question has been considered by the Supreme Court of the United States on several occasions,⁸⁴ and the most recent decision—involving environmental litigation rather than shareholder class or derivative litigation—appears to reflect a more conservative approach to the award of such fees.⁸⁵ The same problem was also considered by the Texas Supreme Court during the survey period. In *Knebel v. Capital National Bank*⁸⁶ devisees under a will successfully brought suit to set aside a sale by the estate of fifty percent of the stock of a closely-held corporation. The sale had been made back to the corporation for about \$43,000 pursuant to an option held to be unenforceable because the other shareholder was also an executor of the estate.⁸⁷ The court formulated a test for the propriety of awarding attorneys' fees. It stated first that to charge attorneys' fees requires the existence of a "common fund" and "[t]he equitable objective is that of distributing the burden of such expenses

83. TEX. BUS. CORP. ACT ANN. art. 2.04B(1) (1956).

84. The principal securities case allowing recovery of attorneys' fees even though there was no monetary recovery is *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375 (1970).

85. *Alyeska Pipeline Serv. Co. v. Wilderness Soc'y*, 421 U.S. 240 (1975), noted in 29 Sw. L.J. 767 (1975).

86. 518 S.W.2d 795 (Tex. 1974).

87. This holding is discussed in the last *Annual Survey*. Hamilton, *supra* note 38, at 157-58.

among those who share in an accomplished benefit.”⁸⁸ Further, the benefit must be “substantial,” and, while “bad faith” is not essential, it must be shown that a refusal to award fees would allow others to obtain “full benefit” from the plaintiff’s efforts, thereby enriching “the others unjustly at the plaintiff’s expense.”⁸⁹ A “substantial benefit” usually is, but need not necessarily be, monetary in nature.

The court had much greater difficulty applying its formulated test to the facts before it. The result of the litigation was that the estate returned the purchase price of the stock and received back a fifty percent interest in a closely held corporation. Estimates of the value of the corporation were between \$600,000 and \$730,000. However, an obvious problem existed in actually realizing the value of the stock, particularly since the other fifty percent was not in friendly hands. The court discussed the problems thus created:

As we have noted, 7-Up Bottling Company, Inc. is a closely held corporation with the Knebel estate and the Respondents owning respective fifty percent interests. Neither can force the other to sell and neither has a controlling interest to sell. They have been disputants in litigation for many years. As to the possible independent sale of the Knebel estate stock, the witness Sherman acknowledged the difficulty in selling fifty percent of the stock of a going business; he testified, ‘. . . who’s going to put money into something and own only fifty percent of it? They want it all’ He did not purport to place a fair market value upon the Knebel stock as such. Nor is there evidence of the liquidation value of the assets of the corporation whether by agreement or by order of the court. This is pointed out in the brief of Mrs. A.G. Saegert, et al., appellants in the Court of Civil Appeals and Petitioners here, where it is stated that the testimony of the witness Louis Garrett concerning the fair market value of the land owned by the corporation was the only testimony of the liquidation value of the assets of the corporation. It is also fair to say that the market value testimony of the witness Henry H. Kuempel was likewise predicated upon a sale of the corporation as a going business and was to the same general effect as the witness Sherman.⁹⁰

The court concluded that it was not shown as a matter of law that the litigation was of substantial benefit to the estate and remanded to the court of civil appeals to determine whether an “implied finding” of the trial court that there was no benefit to the estate could be upheld.⁹¹ Justice Pope dissented on the ground that he believed that a “substantial benefit” was shown by undisputed proof and that, therefore, the proper disposition was to remand directly to the trial court for a determination of the reasonable attorneys’ fees.⁹²

88. 518 S.W.2d at 799.

89. *Id.* at 800.

90. *Id.* at 802.

91. *Id.* at 804. The court of civil appeals remanded the case to the trial court for a fact finding on the question of benefit to the estate. *Knebel v. Capital Nat’l Bank*, 523 S.W.2d 799 (Tex. Civ. App.—Austin 1975, writ ref’d n.r.e.).

92. 518 S.W.2d at 804 (Pope, J., dissenting).

Share Transfer Restrictions. The difficult problem of valuing shares of a closely held corporation is also often involved in option or buy-sell agreements between the corporation and shareholders or among the shareholders themselves. In such agreements it is customary to provide some test by which the value can be determined.⁹³ One case arising during the survey period⁹⁴ involved a stock repurchase agreement which provided that upon the death of a shareholder his estate would receive a price "equal to the adjusted book value . . . as of the last day of the month preceding [the shareholder's] death plus a pro rata share of 90 per cent of the accounts receivable at such time, provided, however, that in the event that the corporation's certified public accountant determine[d] that such value [was] less than \$70,000.00, the corporation shall be obliged to purchase the shares of [the deceased shareholder] for the sum of \$70,000.00 cash."⁹⁵ The corporation in this instance carried life insurance on each of the three shareholders in the face amount of \$70,000 each. When the plaintiff's decedent died, the corporation's certified public accountant valued the interest pursuant to the agreement at a little over \$36,000. As a result the sum of \$70,000 was paid to the decedent's widow. Essentially, three narrow questions were in dispute. First, a question was raised as to whether the life insurance policy should be valued at cash surrender value or at maturity value. The court held that it should be the former (as the CPA had valued it) because the value was to be determined "as of the last day of the month preceding the stockholder's death." At that time the policy had not matured. Second, the court rejected a contention that work in progress but not yet billed should be valued. The court held that in view of the specified provision with respect to accounts receivable as of the last day of the month preceding the date of death, the agreement did not contemplate that any value was to be placed to work in progress. Finally the court rejected contentions based on the refusal of the CPA to revalue depreciated physical assets or deferrals for income tax. While the court expressed reservation about whether such re-evaluations should be permissible because the agreement specified "adjusted book value" rather than "market value," it found it unnecessary to pass on this point since even if these re-evaluations were made the total value of the widow's interest would still be less than \$70,000.⁹⁶

In another case involving share transfer restrictions,⁹⁷ the court refused to construe a provision stating that a shareholder "will not sell, assign, transfer, pledge or in any way dispose of or encumber any . . . shares without first offering . . . the same for sale to the Corporation"⁹⁸ as covering a transfer to a divorced wife pursuant to a court decree. The court stated that share

93. Such agreements are discussed in HAMILTON §§ 673-83.

94. *Garza v. C-G-R, Inc.*, 523 S.W.2d 59 (Tex. Civ. App.—San Antonio 1975, writ ref'd n.r.e.).

95. *Id.* at 60.

96. *Id.* at 62.

97. *Earthman's, Inc. v. Earthman*, 526 S.W.2d 192 (Tex. Civ. App.—Houston [1st Dist.] 1975, no writ).

98. *Id.* at 201.

transfer restrictions were not "looked upon with favor in the law" and were "strictly construed."⁹⁹ While it is unfortunate that such language continues to reappear in cases, it cannot be denied that the result reached is reasonable. Since the interest of the divorced wife in the shares was a substitute for her community property interest in the shares owned by her former husband, she had a continuing property interest and is not a transferee of the same type as a third person unconnected with the shareholder. Indeed the court recognized this basic point by quoting from a Louisiana case in which the co-ownership argument was clearly made.¹⁰⁰

Compelling Transfer of Shares. When shares of stock in a closely held corporation are transferred to a person deemed antagonistic by management, the new shareholder may experience difficulty in persuading the corporation to register the shares in the name of such person. In the case just discussed,¹⁰¹ for example, the divorced wife experienced great difficulty in having the shares awarded her by the divorce court registered in her name. Eventually, she brought suit for conversion, and, while the court ultimately reversed a substantial judgment in her favor, it was clear from the opinion of the court that upon remand a judgment in her favor was likely. A putative shareholder has a choice of remedies: he may sue for conversion, or he may request mandamus, injunction, or similar kinds of mandatory relief to compel registration. The court of appeals defined the circumstances in which a right to sue for conversion arises: There must be an intention to assert an adverse right to the property but neither a wrongful intention nor bad faith is required. Thus, the fact that the corporation may have relied upon advice of counsel, or that the officers believed their actions in refusing to transfer the shares were justified, does not constitute a legal defense to an action for conversion. However, a *qualified* refusal based upon a reasonable qualification or requirement does not constitute a conversion if the qualified refusal is made in good faith. In the case under discussion the officers had not flatly refused to register the transfer, but rather had admitted that Mrs. Earthman had an interest in the stock. Thus, the failure of the court to instruct the jury that such a qualified refusal in good faith might be a defense constituted error. Further, the court stated that it was permissible for corporate officers to delay a requested transfer for a reasonable period of time in order to ascertain whether the transfer was authorized or improper. Here, the facts strongly suggest improper intimidation and threats in an effort to force Mrs. Earthman to sell her shares to the corporation at a favorable price. The court of appeals stated that such conduct might permit the award of punitive or exemplary damages in a stock conversion case, but that it was not proper to make an independent award for mental anguish as a result of such

99. *Id.* at 202, citing *Gulf States Abrasive Mfg., Inc. v. Oertel*, 489 S.W.2d 184 (Tex. Civ. App.—Houston [1st Dist.] 1972, writ ref'd n.r.e.); *Casteel v. Gunning*, 402 S.W.2d 529 (Tex. Civ. App.—El Paso 1966, writ ref'd n.r.e.).

100. *Messersmith v. Messersmith*, 229 La. 495, 86 So. 2d 169 (1956) (a restriction cannot negative a wife's present interest as co-owner).

101. *Earthman's, Inc. v. Earthman*, 526 S.W.2d 192, 202 (Tex. Civ. App.—Houston [1st Dist.] 1975, no writ); see note 97 *supra* and accompanying text.

conduct. In other words, an award of punitive damages for such conduct is dependent upon a determination that a conversion occurred, and an independent award for mental suffering in the absence of a finding of conversion is improper.

Unfair Competition by Former Employees. In the absence of an agreement restricting competition, former employees or officers of a corporation may enter into competition with it. In particular, such persons may utilize general knowledge, skill, and experience required in the former employment without infringing on the rights of the former employer. However, they may not use confidential information or trade secrets acquired or imparted to them in the course of their prior employment. These basic principles were recognized and applied in *Johnston v. American Speedreading Academy, Inc.*¹⁰² In this case, an injunction prohibiting former employees from competing with the former corporation was held to be too broad, but provisions prohibiting solicitation of former customers derived from customer lists, entering into contracts with customers or prospective customers of the former employer, and using confidential material obtained from the former employer were deemed proper.¹⁰³

Incorporation of a Going Business. Article 2.02 of the Texas Miscellaneous Corporation Laws Act¹⁰⁴ requires that a notice be published when "any banking, mercantile or other business firm" incorporates "without a change of firm name." Further, the last sentence of this article states: "Until such notice has been so published for the full period above-named, (one day in each week for four consecutive weeks), no change shall take place in the liability of such form or the members thereof."¹⁰⁵ In *Payne v. Lucas*¹⁰⁶ the Houston court of civil appeals reviewed the background of this provision and the case law that has arisen, and concluded that its protection should be limited to creditors who had previously dealt with the unincorporated firm. A creditor who deals only with a corporation has a duty to make reasonable inquiry as to whom he is dealing with, and cannot hold "the members" personally liable under article 2.02 unless it "acted in justifiable reliance" upon a belief that they were liable.¹⁰⁷ The court described the liability provisions of article 2.02 as "penal in nature" and concluded, therefore, that its scope should not be extended beyond the "clear import of its language."¹⁰⁸ This "import," the court stated, was to protect persons who relied on the unincorporated status of a business and who received no notice that the firm had incorporated.¹⁰⁹ This conclusion, while hardly compelled by the language of the statute, makes the application of this article much more rational. It is

102. 526 S.W.2d 163 (Tex. Civ. App.—Dallas 1975, no writ).

103. *Id.* at 166.

104. TEX. REV. CIV. STAT. ANN. art. 1302-2.02 (1962).

105. *Id.*

106. 517 S.W.2d 602 (Tex. Civ. App.—Houston [1st Dist.] 1974, writ ref'd n.r.e.). See also *Siboney Corp. v. Dresser Indus., Inc.*, 521 S.W.2d 639 (Tex. Civ. App.—Houston [1st Dist.] 1975, writ ref'd n.r.e.), which follows this case.

107. 517 S.W.2d at 607.

108. *Id.* at 606.

109. *Id.* at 607.

regretable that the Texas Supreme Court declined to review this holding only on the ground of "no reversible error."

Redeemable Common Shares. Article 4.09 of the Texas Business Corporation Act unambiguously states that "shares shall be redeemable only if they have a liquidation preference."¹¹⁰ This provision is echoed in article 2.12B, which authorizes a corporation to issue shares of preferred or special classes "subject to the right of the corporation to redeem any shares having a liquidation preference"¹¹¹ *Capital National Bank v. S.E. Realty Corp.*¹¹² involved an action for declaratory judgment seeking to declare invalid redemptive provisions relating to a class of shares that were non-voting, non-cumulative, and without a preference on liquidation. The court read the statutory language in accordance with its plain meaning and affirmed a declaratory order that the redemption provision was unenforceable.¹¹³

Partnerships. A recurring problem in partnership law is whether an arrangement between two or more persons constitutes a partnership, employment, or other relationship. Often arrangements are entered into without legal advice and without consideration of all the consequences of the arrangement. In *Green v. Meadows*,¹¹⁴ for example, two persons entered into an arrangement in which one person put up the money, the other person provided services; profits were to be shared on a basis later to be agreed upon. An assumed name certificate was filed, stating that the sole owner of the business "Meadows and Green" was Green; however, the agreement with the bank opening the checking account of the business was on the bank's standard form for partnerships and described the depositor as a partnership between Meadows and Green. In determining that no partnership existed under these ambiguous circumstances, the court was primarily motivated by the fact that if the business were considered a partnership, it was in violation of Treasury Department rules relating to customs brokers, which require that all members of a partnership be licensed brokers. The case involved unauthorized withdrawals of money from the business account. Such conduct would involve embezzlement if the business were a sole proprietorship but, arguably, would not be criminal at all if the check writer were a partner, since most courts adhere to the rule that a partner cannot embezzle funds of the partnership—an example of the aggregate theory of partnership.¹¹⁵

110. TEX. BUS. CORP. ACT ANN. art. 4.09 (Supp. 1975-76).

111. *Id.* art. 2.12B.

112. 515 S.W.2d 330 (Tex. Civ. App.—Houston [14th Dist.] 1974, no writ).

113. The court stated: "Where the legislature has acted to define the powers and limitations upon corporate entities generally, its prescription should be strictly pursued." *Id.* at 331.

114. 517 S.W.2d 799 (Tex. Civ. App.—Houston [14th Dist.] 1974), *rev'd on other grounds*, 524 S.W.2d 509 (Tex. 1975), *rehearing denied*, 527 S.W.2d 496 (Tex. Civ. App.—Houston 1975, writ *ref'd n.r.e.*).

115. Most of the case law on this proposition is relatively old. *See, e.g., Ex parte Sanders*, 23 Ariz. 20, 201 P. 93 (1921); *Annot.*, 17 A.L.R. 982 (1922). The recent trend of the case law is generally to treat the partnership as a separate entity under the Uniform Partnership Act, and it is possible that a different view might be taken today. A case taking this recent approach is *People v. Sobiek*, 30 Cal. App. 3d 458, 106 Cal. Rptr. 519, *cert. denied*, 414 U.S. 855 (1973), which overruled earlier California cases to hold a partner liable for embezzling from his partnership. The district attorney in

The court, however, did not need to resolve that question squarely in view of the conclusion that no partnership relation existed.

The Texas Uniform Partnership Act has been in effect for fifteen years.¹¹⁶ It is disquieting to see courts decide cases that are clearly controlled by this statute on the basis of early case law without any apparent recognition that there may be a relevant statute dealing with the question. Perhaps this is a result of the fact that much of this statute codifies common law principles and the result is often the same under the statute or case law. One such case arose during the survey period. In *Boyd v. Leasing Associates, Inc.*¹¹⁷ the issue was whether a former partner in a dissolved partnership was liable for debts incurred by a successor who was operating the business. Boyd and Nordstrom originally entered into the restaurant business under the name "Nasa Grill" as a partnership in 1966. Nordstrom operated the business, while Boyd provided the money. Sometime in 1966 the partnership was dissolved by mutual agreement and the business was picked up by one Horne, who continued to run the business and make payments on the various partnership obligations. No notice was given that Boyd was no longer a partner in the partnership. One of the creditors who had dealt with "Nasa Grill" was the plaintiff, who leased automobiles or trucks to the partnership. In connection with this lease, Boyd signed a "Continuing Guaranty" wherein he guaranteed payment of any claims the lessee might have on the lease. The suit involved liability for two trucks leased by Horne after he took over the business. The basic question thereby raised was whether the subsequent transactions with a creditor of the partnership who had no notice of the dissolution "would bind the partnership [as] if dissolution had not taken place."¹¹⁸ This in turn requires resolution of the question whether pursuant to section 9 of the Texas Uniform Partnership Act, Horne's leasing of the two trucks was "for apparently carrying on in the usual way the business of the partnership."¹¹⁹ On the facts there was considerable doubt as to whether the lease of the trucks in question was for purposes of the partnership business, since the need of a small restaurant for fairly large trucks is not self-evident. The court reached the conclusion that the lease was not for the purposes of the partnership business, a proper result on the facts, but did not mention the appropriate provisions of the

the case under discussion testified that he would not have submitted the case to the grand jury if he had known that the putative embezzler was a partner.

116. The Act was adopted in 1961 and became effective on Jan. 1, 1962.

117. 516 S.W.2d 485 (Tex. Civ. App.—Houston [1st Dist.] 1974, writ ref'd n.r.e.).

118. TEX. REV. CIV. STAT. ANN. art. 6132b, § 35(1)(b)(I) (1970) provides in part:

- (1) After dissolution a partner can bind the partnership . . .
- (b) By any transaction which would bind the partnership if dissolution had not taken place, provided the other party to the transaction (1) was a creditor of the partnership at the time of dissolution . . . and . . . had no knowledge or notice of his want of authority.

In the present case, the acts of Horn were attributed to the partnership because, absent notice, Horn acted as an apparent agent of the partnership.

119. *Id.* § 9(2) provides that: "An act of a partner which is not apparently for the carrying on of the business of the partnership in the usual way does not bind the partnership unless authorized by the other partners." (In the situation of this case, Horn was considered an apparent agent of the partnership, acting for Boyd.)

Uniform Partnership Act. Rather, it relied on earlier case law that established essentially the same test as the Uniform Act.

A final partnership case also involved partnership liquidation. The issues were the proper treatment of apparent capital deficits caused by charging depreciation on improvements to real property solely to the account of one partner, and whether loans by a partner to the partnership should be treated as indebtedness or as capital contributions. In *Park Cities Corp. v. Byrd*¹²⁰ a carefully drafted limited partnership agreement provided that the limited partner, the plaintiff corporation, should contribute \$100, and the general partner, Mrs. Byrd, would contribute all additional necessary capital; losses would be shared "according to actual losses suffered by each party."¹²¹ Mrs. Byrd contributed capital of over \$88,000 and loans of over \$1,100,000; consistently, all depreciation was charged to her capital account and she claimed the amounts as tax deductions. The loans were all evidenced by interest-bearing promissory notes. The combination of putting most of the capital in as loans and charging all depreciation to her capital account resulted in an "apparent deficit," but the court held that Mrs. Byrd's estate need not restore that deficit since it did not reflect any withdrawals by or distributions to Mrs. Byrd. An earlier case¹²² which required the restoration of a capital deficit in liquidation was marked by actual distributions to the partner. While the facts are so peculiar that there may be unforeseen problems, the result reached does seem to lead to a just and equitable settlement of partnership relations on the basis of the known facts. While it is difficult to square it with the literal language of the Uniform Partnership Act, this augurs few future difficulties as the situation posed appears to be unique.¹²³

The conclusion that the loans by Mrs. Byrd should be repaid before any distributions on account of capital or income seems clearly right; indeed section 40 of the Texas Uniform Partnership Act squarely contemplates that a partner may also be a creditor to his partnership.¹²⁴

Foreign Corporations. The Texas Business Corporation Act provisions with respect to the qualifications of foreign corporations were designed to encourage foreign corporations transacting intrastate business to obtain a certificate of authority; they were not designed to punish corporations who fail to do

120. 522 S.W.2d 572 (Tex. Civ. App.—Beaumont 1975, writ granted). [Editor's Note: The Texas Supreme Court reversed this case. 19 Tex. Sup. Ct. J. 188 (Feb. 21, 1976).]

121. *Id.* at 574 n.1.

122. *Conrad v. Judson*, 465 S.W.2d 819 (Tex. Civ. App.—Dallas, writ ref'd n.r.c.), cert. denied, 405 U.S. 1041 (1971).

123. TEX. REV. CIV. STAT. ANN. art. 6132b, §§ 18(1)(a), 40(b) (1970) normally requires each partner with a deficit in his capital account to contribute to the partnership, since otherwise he will have withdrawn a greater percentage of his capital than he is entitled to. These provisions, however, may be varied by agreement so far as they affect relations between the partners themselves, and probably the simplest way to justify the result under the UPA is to argue that the peculiar provisions of the partnership agreement show that the parties did agree that Mrs. Boyd's deficit should not be restored.

124. TEX. REV. CIV. STAT. ANN. art. 6132b, § 40(b)(II) (1970) recognizes obligations "owing to partners other than for capital and profits." See also Professor Bromberg's "Source and Comments" analysis of § 40(b), 17 TEX. REV. CIV. STAT. ANN. 396-97 (1970).

so.¹²⁵ Thus, article 8.18 of the Texas Business Corporation Act¹²⁶ provides that while an unqualified foreign corporation may not maintain an action, suit, or proceeding in a court of this state, contracts entered into by an unqualified corporation are not invalid, and a corporation may qualify and then bring suit on pre-qualification contracts. In one case arising during the survey period¹²⁷ an unqualified foreign corporation brought suit to enforce a covenant not to compete. Apparently there was some question about whether the corporation was involved in interstate or intrastate business. The defendant's counsel was well aware that the plaintiff had not qualified to transact business in Texas if it were engaged in intrastate business. However, as a dilatory maneuver, he waited until the morning of the trial before calling this fact to the attention of the judge. Rather than dismissing the proceeding, the judge permitted it to continue. Determining that the plaintiff was entitled to judgment, the court reconsidered the defendant's plea in abatement and granted the plea, but postponed entry of final judgment for thirty days with the stipulation that if the plaintiff failed to file a certificate of authority within that thirty-day period the plea in abatement would be granted; upon filing such a certificate, however, a final judgment granting a permanent injunction would be entered. Needless to say, the plaintiff filed the certificate within the thirty-day period. The court of appeals "commended" the judge for preventing a "dilatory maneuver in a manner that avoided disruption of the docket, that was fair to both parties and yet accomplished the purpose of the statute."¹²⁸ Apparently, the judge had dismissed counsel in other cases in order to permit this trial to proceed and he was justifiably annoyed when the defendant, on the morning of the trial, for the first time raised an impediment to the plaintiff's right to maintain the action.

Interestingly, the plaintiff sought to appeal the order also on the ground that it should not have been required to file the certificate, even though it had filed the certificate to avoid the plea in abatement. Of course, such a filing involves a fee of \$500.¹²⁹ The court, however, refused to consider this appeal on the ground that it was moot. With the filing of the certificate no order of the court could affect the corporation's current position.

Receiverships. The Bar Committee Comment to article 7.04 of the Texas Business Corporation Act states that that article's provisions with respect to receiverships for corporations should govern rather than the provisions of article 2293 of the Texas Revised Civil Statutes.¹³⁰ One case arising in the survey period ordered the appointment of a receiver for a corporation under article 2293 rather than under the Texas Business Corporation Act.¹³¹ Since

125. See HAMILTON § 987.

126. TEX. BUS. CORP. ACT ANN. art. 8.18A (1956).

127. *Troyan v. Snelling & Snelling, Inc.*, 524 S.W.2d 432 (Tex. Civ. App.—Dallas 1975, no writ).

128. *Id.* at 435.

129. TEX. BUS. CORP. ACT ANN. art. 10.01A(4) (1956).

130. *Id.* art. 7.04, Comment.

131. *Collegiate Recovery & Credit Assistance Programs, Inc. v. State*, 525 S.W.2d 900 (Tex. Civ. App.—Waco 1975, no writ).

the provisions of the two statutes are virtually identical, however, there appears to be little ground for attack based on the improper citation of authority.

In addition to case law concerning receiverships, a receivership problem in connection with brokerage firms received legislative correction during the survey period.¹³²

II. SECURITIES REGULATION

Federal. For many years the judicial development of doctrines of federal corporation and securities law were almost exclusively the province of the lower federal courts, particularly the Federal District Court for the Southern District of New York and the Second Circuit. The lower federal courts developed significant new principles under rule 10b-5,¹³³ section 16(b) of the Securities Exchange Act of 1934,¹³⁴ section 14 of the same Act (and the proxy regulations promulgated thereunder),¹³⁵ and, to a somewhat lesser extent, sections 13 and 14 of that Act relating to tender offers and struggles for control.¹³⁶ Under these provisions literally thousands of lower federal court decisions, primarily concerning publicly held corporations, developed a broad (and, until recently, growing) jurisprudence in the federal courts.

A major development in this area in recent years has been the increasing activism of the United States Supreme Court. This activism has not been directed towards the broadening of federal jurisdiction; rather, with the more conservative appointments in recent years, it has strongly tended to limit the growth of litigation in the federal courts. This trend began prior to the present survey period, but its outlines became clearer as a result of several recent decisions. Without summarizing each of these cases at great length, a listing indicates the extent of the Court's "counter-revolution":

(1) *Blue Chips Stamps v. Manor Drug Stores*.¹³⁷ In this case the Court strongly supports the limiting doctrine under rule 10b-5, popularly known as the *Birnbaum* doctrine,¹³⁸ which states that a plaintiff has standing under rule 10b-5 only if it is a purchaser or seller of securities. The majority opinion contains strong criticism of the growth of rule 10b-5 and intimates that this rule may be more narrowly construed in the future. The opinion also specifically reserves the question whether a plaintiff may

132. See note 204 *infra* and accompanying text.

133. 17 C.F.R. § 240.10b-5 (1975).

134. 15 U.S.C. § 78p(b) (1970).

135. 15 U.S.C. § 78n (1970). The proxy regulations appear at 17 C.F.R. §§ 240.14a-1 to -12 (1975).

136. These provisions are usually referred to as the "Williams Act." 15 U.S.C. §§ 78m(d), 78m(e), 78n(d)-(f) (1970).

137. 421 U.S. 723 (1975), *noted in* 29 Sw. L.J. 951 (1975).

138. *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952). The critical language of this case is that rule 10b-5 is "directed solely at that type of misrepresentation or fraudulent practice usually associated with the sale or purchase of securities rather than at fraudulent mismanagement of corporate affairs, and that Rule X-10b-5 [extends] protection only to the defrauded purchaser or seller." *Id.* at 464. The decision in *Blue Chip* may undercut to some extent the expansionist holding in *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6 (1971). For an attempt to rationalize these cases, see *Frigitemp Corp. v. Financial Dynamics Fund, Inc.*, 524 F.2d 275 (2d Cir. 1975).

proceed at all under the more generous provisions of rule 10b-5 when the basis of his complaint is misrepresentation or non-disclosure in an offering that is subject to registration under the Securities Act of 1933.¹³⁹

(2) *Rondeau v. Mosinee Paper Corp.*¹⁴⁰ This case holds that a failure to file under the Williams Act may not be used to support an injunction prohibiting the voting of shares if the failure to file has since been corrected.¹⁴¹

(3) *United Housing Foundation, Inc. v. Forman.*¹⁴² The holding in this case was that shares issued by a cooperative housing corporation were not "securities" for purposes of the federal securities laws.

(4) *Securities Investor Protection Corp. v. Barbour.*¹⁴³ In this case the Court held that a customer of a broker does not have an implied or private cause of action under the Securities Investor Protection Act.¹⁴⁴

(5) *Bangor Punta Operations, Inc. v. Bangor & Aroostook R.R.*¹⁴⁵ This case holds that after a person purchases ninety-eight percent of the stock of a corporation, both the purchaser and the corporation are precluded from suing the sellers for alleged corporate mismanagement occurring before the sale.

In contrast to the above decisions restricting the availability of rule 10b-5 for purposes of litigation, jurisdictional requirements have become increasingly liberal. During the survey period the Fifth Circuit joined an increasing number of circuits in holding that the jurisdictional requirements of rule 10b-5 may be met by a single *intrastate* telephone call.¹⁴⁶

The question of whether suits brought under rule 10b-5¹⁴⁷ in Texas are controlled by the three-year statute of limitations set forth in the Texas Securities Act¹⁴⁸ or the two-year statute applicable to fraud,¹⁴⁹ including violations of section 27.01 of the Texas Business and Commerce Code,¹⁵⁰ is not completely settled. Early case law indicated that the shorter statute would be applied,¹⁵¹ but one federal district court¹⁵² held that the three-

139. 15 U.S.C. §§ 77a-77aa (1970).

140. 422 U.S. 49 (1975).

141. In this case, *Rondeau* purchased more than 5% of the outstanding *Mosinee* stock without filing the statement required by 15 U.S.C. § 78m(d)(1) (1970). When advised of this violation, he promptly filed the certificate. Even though he was then in compliance, the corporation sought to use the violation as a basis for enjoining him from voting the stock and acquiring additional stock.

142. 421 U.S. 837 (1975), noted in 29 Sw. L.J. 987 (1975).

143. 421 U.S. 412 (1975).

144. 15 U.S.C. §§ 78aaa-III (1970).

145. 417 U.S. 703 (1974).

146. *Dupuy v. Dupuy*, 511 F.2d 641 (5th Cir. 1975). For examples of the same position in other circuits see *Spilker v. Shayne Laboratories, Inc.*, 520 F.2d 523, 526 (9th Cir. 1975); *Aquionics Acceptance Corp. v. Kollar*, 503 F.2d 1225 (6th Cir. 1974); *Kerbs v. Fall River Indus., Inc.*, 502 F.2d 731 (10th Cir. 1974); *Myzel v. Fields*, 386 F.2d 718 (8th Cir. 1967), cert. denied, 390 U.S. 951 (1968). Although the court in *Dupuy* cites the Ninth Circuit as having adopted a contrary position in *Burke v. Triple A Mach. Shop, Inc.*, 438 F.2d 978 (9th Cir. 1971), the Ninth Circuit, three months after the decision in *Dupuy*, distinguished and narrowly construed *Burke* in *Spilker v. Shayne Laboratories, Inc.*, supra, at 525.

147. 17 C.F.R. § 240.10b-5 (1975).

148. TEX. REV. CIV. STAT. ANN. art. 581-33C (1964).

149. *Id.* art. 5526.

150. TEX. BUS. & COMM. CODE ANN. § 27.01 (1968).

151. See, e.g., *Aboussie v. Aboussie*, 441 F.2d 150, 156 (5th Cir. 1971).

152. *Richardson v. Salinas*, 336 F. Supp. 997, 1001 (N.D. Tex. 1972).

year statute should govern. During the survey period, the Second Circuit, applying Texas law in a suit transferred from the Northern District of Texas by the Panel on Multidistrict Litigation,¹⁵³ carefully re-examined the question, and also concluded that the three-year statute of the Texas Securities Act should be applied by analogy. The test, according to the court, "is to compare the state causes of action to a rule 10b-5 action and to choose the statute of limitations applicable to that state cause of action which is most similar to the federal cause of action under rule 10b-5 and which best effectuates the rule's purpose."¹⁵⁴

In another rule 10b-5 case arising during the survey period, the Fifth Circuit considered whether a Texas divorce settlement involving shares of stock constitutes a "sale" or "disposition." While the court strongly intimated that a transfer of stock in settlement of community property claims followed by the prompt re-purchase of that stock by the corporation might well constitute a "sale" of the stock for purposes of obtaining jurisdiction under rule 10b-5, it did not definitively so hold;¹⁵⁵ rather, it concluded that it was improper to dismiss the plaintiff's complaint on summary judgment. The court stated:

The precise nature of Spector's interest in the 40 BME shares registered in his wife's name is a matter governed by Texas property law and is not now before us. Suffice it to say, however, that the plaintiff has alleged facts which . . . support a finding that the 40 shares were community property and that before the divorce settlement Spector individually owned an interest in at least some of them, notwithstanding that the shares were registered in his wife's name.¹⁵⁶

The non-disclosure involved in the *Spector* case was a failure fully to disclose plans for a public offering by the corporation of the stock being purchased from the husband.

There was also litigation between securities firms and their customers during the survey period. One case held that where a margined account is "under water," the broker cannot be held liable for failing to mitigate damages if he carries the customer for a period of time and the stock declines further. "[T]he customary practice in the industry," the court stated, "is to give the customer every benefit of the doubt and to accept the customer's check in good faith."¹⁵⁷ The case also involved a lack of good faith by the customer in that he knowingly gave the broker checks when there were not sufficient funds on deposit to cover them. A second case held that an agreement between a sophisticated customer and brokerage firm to arbitrate all disputes was unenforceable to the extent that it required arbitration of claims based on violations of the federal and state securities

153. *Berry Petroleum Co. v. Adams & Peck*, 518 F.2d 402 (2d Cir. 1975).

154. *Id.* at 407. The court, however, affirmed the dismissal of the complaint, in part on the ground that the action was barred even under the three-year statute.

155. *Spector v. L Q Motors Inns, Inc.*, 517 F.2d 278 (5th Cir. 1975).

156. *Id.* at 284-85.

157. *Hornblower & Weeks-Hemphill, Noyes v. D & G Supply & Maintenance Co.*, 390 F. Supp. 715, 719 (N.D. Tex. 1975).

acts.¹⁵⁸ The holding of *Wilko v. Swan*¹⁵⁹ was held to cover sophisticated as well as unsophisticated directors.

State. A decision of some practical importance in the allocation of litigation between the Texas Securities Commission and the courts is *D & S Investments, Inc. v. Mouer*,¹⁶⁰ holding that the commissioner has primary jurisdiction to determine whether or not certain sales of real property by a joint venture arrangement constitute the sale of a "security." The concept of primary jurisdiction relates to whether the court or the agency should decide a question in the first instance; it seems clear that as a matter of economy and efficiency, such questions should first be considered by the commissioner. Further, there is specific statutory language within the Securities Act which recognizes the power of the commissioner to resolve such issues¹⁶¹ and provides for judicial review from the administrative decision.¹⁶²

The definition of a private offering in the Texas Securities Act combines a numerical requirement with the requirement that the sale be "made without any public solicitation or advertisements . . ." ¹⁶³ While the concept of a "public advertisement" creates no difficulty, some uncertainty has existed as to what constitutes a "public solicitation" and how such a "solicitation" differs from a "public advertisement." In a criminal case arising during this survey¹⁶⁴ a court held that the following facts were sufficient to permit the issue of what is a "public solicitation" to be submitted to a jury: First, the defendant had approached persons at such places as delicatessens; second, the defendant had shown a number of graphs and charts concerning stocks and bonds to various persons in an effort to induce people to invest in a "joint venture" in which the defendant was investing funds for others; and third, the defendant had exhibited his graphs and charts to at least thirteen persons, each of whom ultimately invested money in this scheme. While the opinion does not attempt to define "public solicitation," the above facts appear to constitute a public solicitation as that phrase is normally understood. The court also concluded that the joint venture being pushed by the defendant constituted the sale of a security, and a prison term was imposed, as well as a fine of \$1,000.

Finally, during the survey period, an interesting case arose involving the difference between the record date and ex-payment date for the payment of a dividend or interest on a security. Fox and Kiser owned some registered six-and-one-half percent bonds issued by Trans World Airlines. TWA had

158. *Newman v. Shearson, Hammill & Co.*, 383 F. Supp. 265 (W.D. Tex. 1974).

159. 346 U.S. 427 (1953) (an arrangement to arbitrate disputes between a customer and a brokerage firm constitutes a "stipulation" to waive compliance with any "provision" of the Securities Act of 1933 and, thus, was in violation of the Securities Act of 1933, § 14, 15 U.S.C. § 77n (1970)).

160. 521 S.W.2d 118 (Tex. Civ. App.—Austin 1975, writ ref'd n.r.e.).

161. TEX. REV. CIV. STAT. ANN. art. 581-24 (1964). As the court noted in the principal case, other persons had gone to the commissioner to seek an order that the interests they proposed to sell did not constitute "securities." *Clayton Brokerage Co. of St. Louis, Inc. v. Mouer*, 520 S.W.2d 802 (Tex. Civ. App.—Austin 1975, writ ref'd n.r.e.).

162. TEX. REV. CIV. STAT. ANN. art. 581-27 (1964).

163. *Id.* art. 581-5(1).

164. *Cox v. State*, 523 S.W.2d 695 (Tex. Crim. App. 1975).

not made the two previous semi-annual payments and, as a result, the bonds were traded "flat," that is without any accrual of interest between payment dates, much as though they were shares of stock rather than debt securities. In 1972 TWA announced it would make the regular interest payment on June 1, 1972, "to bondholders of record on May 19, 1972," and, at the same time, would make up the missed interest payments. Fox and Kiser decided that the most profitable course would be to sell the bonds on the first day they could do so and yet retain the interest payment. They inquired of their broker, E.F. Hutton & Company, as to what day that would be, and the Dallas office of Hutton contacted the New York office, which advised them as follows: "Transworld Airl—Record Dte on TWA 6 1/2 is May 19. "Owner Could sell Bonds. May 20 and Still get Arrearage." This information was wrong. The record date simply establishes to whom a payment is made; as between buyer and seller of securities entitlement to a payment is based on the "ex" date. If a sale is made before the "ex-payment" or "ex-dividend" date, the buyer is entitled to the payment; if made after that date, the seller receives the payment.¹⁶⁵ Since the TWA bonds were traded "flat" the "ex" date is the date of the payment itself, so that the first day Fox and Kiser could have sold the bonds and retained the interest was June 2.¹⁶⁶

Acting on this erroneous information, Fox and Kiser sold their bonds on May 22 and later, learning that they were not entitled to the interest payment, sued the broker for that payment. The trial court entered judgment for the amount of the payment, but the court of appeals reversed.¹⁶⁷ While the court's opinion expresses doubt whether brokers' customers should be permitted to recover under such circumstances on theories of reliance or promissory estoppel, its reversal was apparently based primarily on the incorrect measure of damages. Before the ex-payment date the price of the TWA bonds clearly reflected the right to receive the payments. Between May 19 and June 1 the price of the bonds fluctuated in the 93-95 range (from \$930 to \$950 for a \$1,000 bond); on

165. Problems with respect to entitlement to dividends are minimized by the usual New York Stock Exchange practice of setting the ex-payment date four days *before* the record date. Since a buyer actually receives the certificate five days after the transaction, a buyer before the ex-payment date can register the transfer on or before the record date and thus ensure receipt of payment. See NYSE MANUAL A-155, A-156 (1968). Of course, a buyer before the "ex-payment" date is entitled to the dividend even if he does not register the transfer on or before the record date.

166. A witness explained how sales after the record date but before the ex-payment date are handled:

On any sale after the record day and until the interest payment day, the broker was required to attach to the bonds when delivered a 'due bill' showing that the interest, when received, would be paid over to the purchaser. Consequently, if defendant sold the bonds in question before June 2, it would have been required to give a due bill committing it to pay the interest when received to the purchaser

518 S.W.2d at 854. This is the procedure set forth in the New York Stock Exchange Manual for situations where the record date occurs before the "ex-payment" date. NYSE MANUAL A-156 to -161. The due bill is redeemed on a date fixed by Exchange ruling. Due bills are in standard form prepared by the Exchange; the manner of their execution and guaranty is also prescribed by Exchange rules.

167. E.F. Hutton & Co. v. Fox, 518 S.W.2d 849 (Tex. Civ. App.—Dallas 1974, writ ref'd n.r.e.).

June 2, when the bonds traded ex-payment, the bonds dropped to between 85 and 87, reflecting the payment. Hence, even accepting a reliance or promissory estoppel theory of recovery, the plaintiffs would clearly be over-compensated if they received both the full sales price for the bonds on May 22 and the full interest payment from the broker. If the plaintiffs had done what they planned to do—*i.e.*, sell the bonds on the first day that they would be allowed to keep the interest payment—the bonds would have been sold in the 85-87 range, not the 93-95 range. As it turned out, if the bonds had been sold on June 2 at the opening price, Fox and Kiser would have made a little more than they did by the May 22 sale, but the difference would have been measured in the hundreds, not thousands, of dollars. Hutton, the broker, had voluntarily offered to pay this smaller amount, but the plaintiffs were unsuccessfully shooting for the moon.

III. LEGISLATIVE, ADMINISTRATIVE, AND RELATED DEVELOPMENTS

A. *The 1975 Amendments to the Texas Business Corporation Act*

These amendments are part of a continuing effort by the Section on Corporation Banking and Business Law of the State Bar of Texas to provide a flexible, modern, and simple business corporation statute well adapted to the needs of the state.¹⁶⁸ The 1975 amendments were primarily designed to resolve problems that had arisen under the much more substantial amendments to the TBCA in 1973 or that had been overlooked in those amendments. The 1975 amendments can be broken down into three broad areas.

*Share Transfer Restrictions.*¹⁶⁹ The statutory provisions relating to share transfer restrictions and to the form of certificates evidencing shares subject to such restrictions were totally overhauled in 1973, partially in response to a major Texas Supreme Court decision in the area.¹⁷⁰ This overhaul resulted in several confusing provisions. Therefore, the 1975 amendments were designed to restructure and clarify the existing provisions without making major substantive change. The only substantive changes are the following:

(1) The definition of "conspicuous" was removed from article 2.19H and placed in article 1.02A(19), the definitional section in which it logically belongs, and "the location of such information" was specified as another method of satisfying the requirement that certain information appearing on a certificate be conspicuous.¹⁷¹

(2) Article 4.01B(19)¹⁷² was added to the provisions relating to the

168. The 1975 amendments are carefully and comprehensively analyzed in Bateman & Dawson, *The 1975 Amendments to the Texas Business Corporation Act and The Texas Securities Act*, 6 TEX. TECH L. REV. 951 (1975) [hereinafter cited as Bateman & Dawson].

169. *Id.* at 954-63.

170. *Ling & Co. v. Trinity Sav. & Loan Ass'n*, 482 S.W.2d 841 (Tex. 1972) (failure to comply with statutory requirement regarding buy-sell agreement resulted in restriction being interpreted as option to corporation to purchase, and, therefore, was not necessarily ineffective against bank using stock as security for loan).

171. TEX. BUS. CORP. ACT ANN. art. 1.02A(19) (Supp. 1975-76).

172. *Id.* art. 4.01B(19).

permissible amendments of articles of incorporation to make it clear that amendments may restrict the transfer of securities in accordance with the new article 2.22F.¹⁷³

(3) In a major improvement of overlapping and confusing provisions, article 2.19G was modified to permit share certificates to state *either* that a copy of the document in which the transfer restriction is based will be furnished upon request by the corporation, *or* that the document is on file in the office of the secretary of state.¹⁷⁴ Further, article 2.22E now permits but does not require a corporation that had adopted a bylaw or is a party to an agreement restricting the transfer of shares to make the bylaw or agreement "a matter of public record" by filing with the secretary of state, thereby permitting only a reference on the certificate that the bylaw or agreement is available from the secretary of state.¹⁷⁵ If the corporation does not wish to make the bylaw or agreement a matter of public record, it must be prepared to make a copy of the document available upon request under article 2.19G.¹⁷⁶ These simple and straightforward provisions are a welcome relief from the confusion that existed under the prior statute.

(4) Finally, the new article 2.22F preserves a minor anomaly found in the 1973 amendments by permitting incorporation by reference of a restriction agreement into the articles of incorporation.¹⁷⁷

Close Corporation Provisions. The close corporation provisions of the 1973 amendments were an ambitious attempt to develop an integrated set of provisions suitable for the corporation with few shareholders. Such provisions, which at first blush seemed rather simple and straightforward, had a tendency to become involved as the draftsmen sought to cover all possible contingencies. After the 1973 amendments were adopted several problems developed which the 1975 amendments address.¹⁷⁸ However, the result is

173. *Id.* art. 2.22F; see note 177 *infra* and accompanying text.

174. TEX. BUS. CORP. ACT ANN. art. 2.19G (Supp. 1975-76).

175. *Id.* art. 2.22E.

176. *Id.* art. 2.19G.

177. *Id.* art. 2.22F. The only reason to do this is a difference in filing fees. The filing fee for articles of amendment is \$100, *id.* art. 10.01A(2), while the fee for filing a bylaw or agreement is \$10.00. *Id.* art. 10.01A(22). Otherwise, the amendment provisions seem equally convenient, though one can envision situations where a corporation might be concerned about the appearance created by placing long documents directly in otherwise short articles of incorporation.

178. The principal problems are described in the Bar Committee comment to TEX. BUS. CORP. ACT ANN. art. 2.30-1 (Supp. 1975-76) as follows:

[F]our specific questions arose after adoption of the close corporation provisions concerning their operation upon corporations which met the definition but did not desire to have the status of a close corporation. One, the agreement among shareholders permitted by Art. 2.30—2A could encompass matters which other provisions of the Act permit to be made the subject of an agreement among any two or more, but not all, shareholders of the close corporation in addition to matters which may constitute significant variations from the corporate norm that are permitted only under the close corporation provisions. There was some question whether Art. 2.30—2A prohibited any agreement among shareholders of a corporation which met the definition of a close corporation unless all shareholders became a party to it. If the corporation and its shareholders did not intend in the first instance to be a close corporation, such an interpretation of Art. 2.30—2A would have unduly restricted the right of its shareholders to contract among themselves in manners otherwise permit-

both forbidding and disappointing: several pages of complex statutory provisions are followed by several pages of equally complex "Comments" explaining the provisions. In addition, the recent law review article carefully explaining the 1975 amendments itself is difficult reading.¹⁷⁹ Further, this article points to a number of uncertainties and ambiguities in these sections which were created by the 1975 amendments and questions the need for multiple incorporators of close corporations in some circumstances.

Fortunately, one of the major changes made by the 1975 amendments was to give each potentially qualifying corporation an option whether or not to become subject to these provisions.¹⁸⁰ The option is exercised by including certain provisions in the corporation's articles of incorporation. It is my view that most corporations do not need the special provisions, and the simplest course for most attorneys to follow in the future is not to elect inclusion under these forbiddingly complex statutes. The only situations where election should be seriously considered are:

(1) Where the plan of incorporation involves execution of agreements that may arguably restrict the discretion of directors in a way that may make such agreements unenforceable as against public policy;¹⁸¹

(2) where there will be only one or two shareholders, and the option to eliminate the board of directors and have business conducted directly by the shareholders is attractive (though the option to have one or two directors without electing close corporation status may be equally satisfactory); and

(3) where a minority shareholder desires to have an option to force the dissolution of the corporation (though an option to dissolve may often be provided by a shareholders' agreement or stand-by voting trust without electing close corporation status).¹⁸²

ted by the Act. Two, Art. 2.30—2B provides that an agreement among shareholders of a close corporation must be set forth in or made a part of either the articles of incorporation or bylaws of the close corporation in order for it to be valid. There was some question whether Art. 2.30—2B might be interpreted to mean that an agreement restricting transfer of shares among the shareholders of a corporation which did not intend to be a close corporation but in fact met the definition would not be valid even though the agreement met the requirements of Art. 2.22 and Art. 2.19F (repealed by the 1975 amendments and replaced in this respect by Art. 2.22F) for corporations generally. Three, Art. 2.30—3 permits the shareholders of a close corporation to petition a court to enjoin the corporation from taking any action which may cause it no longer to be a close corporation. In this case, if a corporation which met the definition of a close corporation but which did not and never intended to be a close corporation decided to make a public offering of its shares, or to sell shares to an additional number of persons after which the total number of holders would exceed the permissible limitation, any of the shareholders of a corporation could petition a court to enjoin the public offering or sale. Four, Art. 2.30—4 provides for the appointment of a professional director upon application of any shareholder of a corporation which meets the definition of a close corporation, whether or not it intended to be a close corporation, in order to break deadlocks among the shareholders or directors.

State Bar of Texas, *Comment of Bar Committee*, 3A TEX. REV. CIV. STAT. ANN. 87-88 (Supp. 1975-76).

179. Bateman & Dawson 963-90.

180. TEX. BUS. CORP. ACT ANN. art. 2.30-1A (Supp. 1975-76).

181. See HAMILTON §§ 425, 687.

182. See *id.* § 690.

The 1975 amendments made a number of substantive changes to the statutory provisions, and a simple listing of the most significant ones may be helpful:

(1) As indicated above, a corporation becomes subject to these provisions only by a voluntary election indicated by including specified provisions in the articles of incorporation;

(2) the maximum number of shareholders in a close corporation has been increased to thirty-five;¹⁸³

(3) following the *delectus personae* concept of partnership law, a close corporation may specify shareholder qualifications and may exclude certain persons or classes of persons from being shareholders;¹⁸⁴

(4) all the initial subscribers to stock of a close corporation must serve as incorporators of the corporation;¹⁸⁵

(5) where a close corporation has elected to be governed by the shareholders without a board of directors, it is made clear that in the event of disagreement, votes are counted in proportion to the number of shares held rather than per capita;¹⁸⁶ and

(6) the provisions relating to shareholders agreements were modified in two major respects. First, it is plainly stated that a failure to comply with the precise requirements of article 2.30-2 does not invalidate an agreement that would be valid under other provisions of the Texas Business Corporation Act if the corporation were not a close corporation.¹⁸⁷ The principal effect of this change is to make clear that agreements between some—but not all—shareholders of a close corporation are valid where they comply with requirements of article 2.30B as a pooling agreement. Second, it is evident from the amendments that agreements are enforceable not only as against the parties themselves but also as against persons acquiring shares from a party by gift, bequest, or inheritance.¹⁸⁸

*Simplification of Corporate Formalities.*¹⁸⁹ In addition to correcting several oversights and anomalies in the Texas Business Corporation Act, the 1975 amendments include several minor amendments designed to simplify procedures to be followed by business corporations. Thus, the requirements as to incorporators were drastically simplified. The number of incorporators required was reduced from three to one; the requirement that they be Texas citizens was dropped; the age requirement of natural persons was reduced from twenty-one to eighteen; and corporations, partnerships, trusts, and estates are now permitted to serve as incorporators.¹⁹⁰ These changes reflect the relatively minor role played by incorporators under the Texas Business Corporation Act. Also, the various provisions of the Act that confused the requirement of \$1,000 initial capital with a minimum amount of stated

183. TEX. BUS. CORP. ACT ANN. art. 2.30-1A(4) (Supp. 1975-76).

184. *Id.* art. 2.30-1B.

185. *Id.* art. 2.30-1D.

186. *Id.* art. 2.30-1G(3).

187. *Id.* art. 2.30-2F.

188. *Id.* art. 2.30-2C.

189. Bateman & Dawson 990-95.

190. TEX. BUS. CORP. ACT ANN. art. 3.01 (Supp. 1975-76).

capital were dropped,¹⁹¹ thereby eliminating the basis for the questionable rule adopted by the secretary of state's office that a corporation issuing only par value securities must authorize enough shares so as to produce \$1,000 of stated capital if all shares were issued.¹⁹² Relatively minor changes were also made in provisions relating to removal of committee members by the board of directors, filing fees, dissolution before commencing business, and qualification of foreign corporations.¹⁹³

B. *The 1975 Amendments to the Texas Securities Act*¹⁹⁴

By far the most significant change in the Securities Act is the provision giving broad rulemaking authority to the State Securities Board. While the board has published numerous "interpretations" and "guidelines" in the past, they lacked the force and effect of law and were subject to abrupt change or discontinuance. Further, in some instances the lack of rulemaking authority resulted in the board's being forced to seek an opinion from the attorney general as to the scope of its powers or meaning of the terms of the state Securities Act.¹⁹⁵ Under section 28-1 the board now has power to adopt rules "necessary to carry out and implement the provisions" of the Act, including power to define the terms used in the Act "insofar as the definitions are not inconsistent with the purposes fairly intended by the policy and provisions of this Act."¹⁹⁶ Before adopting rules and regulations the board must follow the notice and comment provisions for rulemaking required by the recently enacted Administrative Procedure and Texas Register Act.¹⁹⁷ This broad authority has been delegated by the board to the securities commissioner as contemplated by the provisions of the Act.¹⁹⁸

Acting promptly pursuant to this grant of authority, the State Securities Board has issued final rules, establishing procedures for future rulemaking and contested cases, defining terms, and largely recodifying its numerous previously issued "interpretations" and "guidelines." Copies of these rules and regulations may be obtained directly from the State Securities Board.

The 1975 amendments also make several rather technical changes in the Act to deal with new problems that have arisen since 1973. Only a brief description seems necessary:

(1) A carefully drafted, narrow exemption from the registration provisions of the Act for certain puts, calls, and other options was added.¹⁹⁹ This provision was felt necessary to permit free trading in these options as

191. *Id.* arts. 4.01C, 4.09A(5), 4.12E.

192. This "rule" is discussed in HAMILTON § 392.

193. TEX. BUS. CORP. ACT ANN. arts. 2.43, 6.01A, 8.02, 8.05, 10.01 (Supp. 1975-76).

194. *See generally* Bateman & Dawson 995-1017.

195. *Id.* at 999-1001.

196. TEX. REV. CIV. STAT. ANN. art. 581-28-1A (Supp. 1975-76).

197. *Id.* art. 6252-13a, § 4. The Securities Act amendments prescribe a similar procedure, *id.* art. 581-28-1G,-28-1L, but these provisions were included only to take care of the possibility that the Administrative Procedure and Texas Register Act might not be enacted, and they are superseded by that Act. *Id.* art. 581-28-1F.

198. State Securities Board, Rules & Regulations § I(A)(3) (1976).

199. TEX. REV. CIV. STAT. ANN. art. 581-5(S) (Supp. 1975-76), *discussed in* Bateman & Dawson 996-1004.

a result of an opinion by the Texas Attorney General that they were "securities" subject to the Act.

(2) A decision by the Waco court of civil appeals²⁰⁰ that a person rendering services in an exempt *transaction* could not recover compensation unless he or she was a registered broker or dealer was, in effect, overruled by modifying the statute to eliminate the constructional base on which the court reached its conclusion.²⁰¹

(3) Another carefully drafted and narrow provision permits the commissioner to obtain a receivership for persons acting as securities dealers in conjunction with his investigation of potentially fraudulent activities under section 32 of the Texas Securities Act.²⁰² This amendment was felt to be necessary because of a holding by the Dallas court of civil appeals that only a court in the county of the corporation's registered office could order a receivership.²⁰³ This holding might have resulted in the state's being forced to institute independent proceedings in two different counties in connection with a single fraudulent practice; it seems clearly desirable to permit the state in an appropriate case to pursue the remedies of injunction and receivership in a single proceeding in a single county.

C. Regulations of the Securities and Exchange Commission

The availability of exemptions from federal registration requirements is a matter of great concern for most fairly small corporations engaged in the raising of capital. The exemptions usually availed of include the private offer exemption,²⁰⁴ the intrastate offer exemption,²⁰⁵ and "Regulation A" (which requires what is in effect an abbreviated registration process).²⁰⁶ During the survey period the Securities and Exchange Commission adopted a new rule 240,²⁰⁷ an "exemption of certain limited offers and sales by closely held issuers" that may be of considerable practical use for the small corporation. The exemption is a limited one: it is available only to issuers that have fewer than 100 beneficial owners both before and after the offering. Further, no more than \$100,000 may be raised under rule 240 in any twelve-month period, no "general advertising or general solicitation" may be used, and no commission or other remuneration may be paid for solicitation of prospective buyers.²⁰⁸

200. *Rowland Corp. v. Integrated Systems Technology, Inc.*, 488 S.W.2d 133 (Tex. Civ. App.—Waco 1972, writ ref'd n.r.e.).

201. TEX. REV. CIV. STAT. ANN. art. 581-34 (Supp. 1975-76), *discussed in* Bateman & Dawson 1010-13.

202. *Id.* art. 581-25-1, *discussed in* Bateman & Dawson 1013-17.

203. *King Commodity Co. of Texas, Inc. v. State*, 508 S.W.2d 439 (Tex. Civ. App.—Dallas 1974, no writ). In this case the attorney general argued that the receivership provisions of the Texas Business Corporation Act were of limited application and the older, more general, provision relating to receivership could be applied. The court rejected this argument. *See also* note 132 *supra* and accompanying text.

204. 15 U.S.C. § 77d(2) (1970). *See generally* HAMILTON § 753.

205. 15 U.S.C. § 77c(11) (1970).

206. 17 C.F.R. §§ 230.251-.263 (1975).

207. *Id.* § 230.240.

208. It should be added that the exemption is only available to issuers, not controlling shareholders. And, of course, the question of the availability of an exemption under

Securities issued pursuant to rule 240 are restricted exactly as are shares issued under the private offering exemption. Each issuer taking advantage of rule 240 must take steps to ensure that each purchaser is acquiring the securities for his own account, that the purchaser is aware of such restrictions, and that an appropriate legend is placed on each certificate. Notice that this exemption has been availed of must be given to the SEC on a new annual form, form 240.

Of course, in this day and age, \$100,000 is not a great deal of capital for many businesses. If more than that is required, and no other exemption is available, some form of registration or compliance is necessary. Rule 240 is apt to be particularly useful in connection with initial capitalizations, such as thirty persons, some non-residents, contributing \$1,000 to \$5,000 each. It is unlikely that an offering to thirty persons could be considered a private offering under the Federal Securities Act even though it falls within the more mechanical tests of the private offering exemption of the Texas Securities Act. So long as the total raised is under \$100,000, rule 240 would appear to be tailored for such situations.

D. *The ABA's Position on the Responsibility of Attorneys in Securities Matters*

The role and responsibility of attorneys who give advice and render opinions in securities matters has been a matter of controversy for the last several years. In several cases the Securities and Exchange Commission has asserted that an attorney has an obligation to the public to prevent violations of the securities acts as well as an obligation to his client. The famous complaint in *SEC v. National Student Marketing Corp.*,²⁰⁰ in which two prestigious law firms were named as defendants, has been followed by speeches by SEC officials,²¹⁰ and several cases in which attorneys were named as defendants, some of which arose during the survey period.²¹¹

the Texas Securities Act is unaffected by rule 240. Finally, the exemption is only from the registration requirements; the antifraud provisions, particularly rule 10b-5, continue to be applicable to closely held corporations if they utilize the mails or any means of interstate commerce.

209. [1971-72 Transfer Binder] CCH FED. SEC. L. REP. ¶ 93,360 (D.D.C. 1972). The filing of this complaint is noted at 50 TEXAS L. REV. 1265 (1972). The proceeding against the attorneys is still being contested. See *SEC v. National Student Marketing Corp.*, 402 F. Supp. 641 (D.D.C. 1975).

210. See, e.g., Sommer, *Professional Responsibility: How Did We Get Here?*, 30 BUS. LAW. 95, 96 (1975); Sommer, *The Commission and the Bar: Forty Good Years*, 30 BUS. LAW. 6 (1974).

211. The most significant case is *SEC v. Spectrum, Ltd.*, 489 F.2d 535 (2d Cir. 1973), in which the court ordered a hearing to determine whether an attorney giving an opinion letter as to the availability of an exemption from registration should be enjoined from further violations of the Securities Act. The court stated that an attorney might be liable as an "aider and abettor" if he were negligent, and that actual culpability—knowledge of the improper scheme plus an intent to further that scheme—was unnecessary. The court said:

The legal profession plays a unique and pivotal role in the effective implementation of the securities laws. . . . In the distribution of unregistered securities, the preparation of an opinion letter is too essential and the reliance of the public too high to permit due diligence to be cast aside in the name of convenience. The public trust demands more of its legal advisers than 'customary' activities which prove to be careless.

Id. at 541. See also *SEC v. Dolnick*, 501 F.2d 1279 (7th Cir. 1974). But see Wood-

The American Bar Association has sturdily resisted the imposition of special public responsibilities on the attorney as being fundamentally inconsistent with his responsibility to his client. A focal point of this debate has been over the responsibility of an attorney to advise the Commission of possible securities violations that he learns of in his capacity as an attorney.²¹² In February 1974 the disciplinary rules of the ABA were amended to read as follows:

Rule 7-102(b) A lawyer who receives information clearly establishing that—(1) his client has, in the course of the representation, perpetrated a fraud upon a person or tribunal shall promptly call upon his client to rectify the same, and if his client refuses or is unable to do so, he shall reveal the fraud to the affected person or tribunal, *except when the information is protected as a privileged communication.*²¹³

The addition of the italicized language has formed the basis of an opinion by the Ethics Committee of the American Bar Association seeking to restore the traditional rule about divulgence of clients' confidences.²¹⁴ The Ethics Committee of the Texas Bar Association also released a formal opinion during the survey period, restating the traditional rule and urging the SEC not to call upon attorneys to divulge clients' confidences.²¹⁵ This opinion refers to DR7-102 quoted above before its amendment. Both opinions emphasize that the duty to disclose confidences under this disciplinary rule should exist only when "fraud"—that is, active fraud with a requirement of *scienter* or intent to deceive—is "clearly" established. In most instances of possible securities fraud it will be difficult to show that an attorney was "clearly" aware of such fraud in view of the uncertainty of the application of numerous securities concepts. On the other hand, if an attorney is aware of such conduct, he is likely to be personally responsible as an aider and abettor, if not more.

The American Bar Association has also adopted a formal statement of policy that lawyers should not be compelled to disclose information about violations of the securities acts other than as set forth in the disciplinary rules in the absence of a specified statute requiring such a change in the traditional rule. The policies set forth in those rules, it was argued, "are essential to the preservation of the concept of the attorney-client relationship as part of our legal system," and the "statutes administered by the SEC give it no power to require disclosure by lawyers concerning their clients beyond

ward v. Metro Bank, No. 742877 slip opinion (5th Cir., Nov. 3, 1975), and SEC v. Coffey, 493 F.2d 1304 (6th Cir. 1974), *cert. denied*, 420 U.S. 908 (1975), applying a stricter liability standard for aiders and abettors. See also White v. Abrams, 495 F.2d 724 (9th Cir. 1974), adopting a flexible or sliding scale approach to the determination of liability. It is settled that a different standard is applicable in criminal proceedings. United States v. Koenig, 388 F. Supp. 670, 712 (S.D.N.Y. 1974).

212. See Lipman, *The SEC's Reluctant Police Force: A New Role for Lawyers*, 49 N.Y.U.L. REV. 437 (1974).

213. ABA CODE OF PROFESSIONAL RESPONSIBILITY DR 7-102(B), *as amended*, (Feb. 1975) (emphasis added).

214. Formal Opinion 341 (Sept. 30, 1975), published in 61 A.B.A.J. 1543 (1975).

215. Opinion 378 (Dec. 1974), published in 38 TEX. B.J. 156 (1975).

what is provided in the CPR."²¹⁶ Thus, the lines of disagreement between the SEC and ABA seem clearly drawn.

Another active area of dispute between attorneys and accountants is whether attorneys should be compelled to disclose information about "unasserted claims"²¹⁷ in response to requests for information about liabilities from auditors preparing accurate financial statements. During the survey period an ABA committee released its final report, which was approved by the Council of the Section of Corporation, Banking and Business Law of the American Bar Association.²¹⁸ Early in January 1976²¹⁹ a compromise was announced under which the legal profession agreed to accept greater responsibility to advise clients as to when securities law requires disclosure of "unasserted claims" on the understanding that the attorney would not be required to disclose such claims to auditors unless the client had already disclosed them. Presumably, an attorney would feel compelled to withdraw from the representation if a client consistently ignored advice that securities law required disclosure of some unasserted claim. The precise nature of this compromise will be reflected in model audit letters agreed to by representatives of the American Bar Association, and the American Institute of Certified Public Accountants.²²⁰

216. *Statement of Policy Adopted by American Bar Association Regarding Responsibilities and Liabilities of Lawyers in Advising with Respect to the Compliance by Clients with Laws Administered by the Securities and Exchange Commission*, 31 BUS. LAW. 543, 547 (1975).

217. These are possible liabilities for such things as product defects of which the attorney is aware but which have not matured or have not been asserted.

218. *Lawyers' Responses to Auditors' Requests for Information—A Report by the Committee on Auditors' Inquiry Responses*, 31 BUS. LAW. 561 (1975). Earlier versions of this report appear at 30 BUS. LAW. 513 (1975); 30 BUS. LAW. 989 (1975).

219. *Lawyers and Auditors Find Compromise of Client Firm's Liabilities*, Wall Street Journal, Jan. 8, 1976, at 6, col. 2.

220. The general problem of the obligations of auditors and attorneys under the securities acts has given rise to considerable discussion during the survey period. See, e.g., Call, *Attorneys' Malpractice Insurance—Does Your Policy Cover Rule 10b-5 Liability?*, 30 BUS. LAW. 1095 (1975); Chalmers, *The Independent Auditor—Guarantor or Guide?*, 31 BUS. LAW. 367 (1975); *Proceedings, ABA National Institute: Advisers to Management—Responsibilities and Liabilities of Lawyers and Accountants*, 30 BUS. LAW. (Special Issue, March 1975); *Symposium, The Murky Divide: Professionalism and Professional Responsibility, Business Judgment and Legal Advice—What Is a Business Lawyer?*, 31 BUS. LAW. 457 (1975). See also Bialkin & Grienberger, *Summary of the Meeting Between Members of the Securities and Exchange Commission and Representatives of the Federal Regulation of Securities Committee, Washington D.C.—January 2, 1975*, 30 BUS. LAW. 1341, 1342-46 (1975).