

January 1986

Corporations and Partnerships

Robert W. Hamilton

Recommended Citation

Robert W. Hamilton, *Corporations and Partnerships*, 40 Sw L.J. 219 (1986)
<https://scholar.smu.edu/smulr/vol40/iss1/10>

This Article is brought to you for free and open access by the Law Journals at SMU Scholar. It has been accepted for inclusion in SMU Law Review by an authorized administrator of SMU Scholar. For more information, please visit <http://digitalrepository.smu.edu>.

CORPORATIONS AND PARTNERSHIPS

by

Robert W. Hamilton*

THIS annual survey of developments in Texas law, like other even-year surveys I have prepared,¹ discusses first the legislative changes relating to corporations and partnerships. In this instance the changes are those adopted during the 1985 legislative session. The Article then considers cases dealing with partnerships and corporations and discusses them under broad, topical descriptions.

I. STATUTORY DEVELOPMENTS

In what has become virtually a biannual event, the Sixty-Ninth Texas Legislature in 1985 enacted without change a bill relating to the Texas corporation statutes developed by a committee of the Texas Bar Association and formally endorsed by that Association.² The bill primarily makes changes in the area of conflict-of-interest transactions between a director and his corporation and in the issuance of series of securities authorized by the board of directors rather than the shareholders. The legislature made other less important changes; it addressed problems that arise when professional corporations practice law in more than one state. It also enacted legislation that allows banking corporations to register their names with the secretary of state to prevent their use by ordinary business corporations. On the other hand, for the second consecutive session, an important bill, strongly pushed by the state bar and making significant changes in the procedures and underlying philosophy of the Texas Securities Act, narrowly failed of enactment.

Copyright 1986 by Robert W. Hamilton.

* A.B., Swarthmore College; J.D., University of Chicago School of Law. Benno C. Schmidt Professor of Business Law, University of Texas at Austin School of Law.

The assistance of Patricia O. Alvarez, a student at the University of Texas School of Law, in the preparation and editing of this Survey Article is gratefully acknowledged.

1. Hamilton, *Corporations and Partnerships, Annual Survey of Texas Law*, 38 Sw. L.J. 235 (1984); Hamilton, *Corporations and Partnerships, Annual Survey of Texas Law*, 36 Sw. L.J. 227 (1982); Hamilton, *Corporations and Partnerships, Annual Survey of Texas Law*, 34 Sw. L.J. 231 (1980); Hamilton, *Corporations and Partnerships, Annual Survey of Texas Law*, 32 Sw. L.J. 221 (1978); Hamilton, *Corporations, Annual Survey of Texas Law*, 30 Sw. L.J. 153 (1976); Hamilton, *Corporations, Annual Survey of Texas Law*, 29 Sw. L.J. 146 (1975); Hamilton & Shields, *Corporations, Annual Survey of Texas Law*, 25 Sw. L.J. 88 (1971).

2. TEX. BUS. CORP. ACT ANN. (Vernon Supp. 1986).

*A. Changes in the Financial Provisions of the Texas
Business Corporation Act*

In 1985 the Texas Legislature adopted amendments to the Texas Business Corporation Act clarifying the powers of the corporation and its board of directors in the creation of new classes and series of shares.³ Because of ambiguities in the prior versions of the Texas Business Corporation Act the question remains whether the changes constitute solely clarifications or whether they also involve a substantive broadening of the power of corporations and their boards of directors.⁴

The recent period of high interest rates caused a tremendous surge in the development of new classes and types of shares used to raise capital. These classes arose basically at the request of providers of capital to give desired tax benefits or economic protection, and there appears to be no sound policy reason to deny Texas corporations the power to create these novel classes.

Several popular variations of these novel shares exist.

(1) A corporation providing venture capital to another may request that the transaction take the form of an issuance of a class or series of preferred shares carrying a fixed dividend rate, but with the investor having the right to "put" the shares back to the corporation at a fixed price at any time. Such shares, usually described as preferred shares redeemable at the option of the holder, enable the provider of capital to have essentially the benefits of a holder of a demand note coupled with the receipt of periodic payments in the form of dividends subject to the eighty-five percent dividend credit provided by the Internal Revenue Code.⁵ If the corporation ever omits the dividend, the corporation that provided the capital may immediately exercise the "put."

(2) For somewhat related reasons, a provider of capital may wish to have the shares redeemed automatically upon some ascertainable event such as changes in the prime rate or the passage of some specified period of time.

(3) Another variation often found in modern financing transactions involves a class of preferred shares that contains affirmative or negative covenants on the part of the corporation, the breach of which permit the holders to exercise specified remedies and at the same time allows the remedies to be waived by the vote or consent of some specified percentage of the holders of the preferred shares. A typical example is a provision that allows the holders of a class of preferred shares to elect a majority of the board of directors

3. *Id.* arts. 2.12, 2.13.

4. Material prepared by members of the Committee of the State Bar working on these amendments indicates that many Texas corporations were in fact issuing securities of the type permitted in the amendments under prior law. Early drafts of the proposed legislation contained provisions that clearly would have broadened this power in novel ways, e.g., to authorize the articles of incorporation to permit the board of directors to reclassify shares so as to create new classes with preference over existing classes without shareholder approval and to authorize the corporation to increase the percentage of shareholders needed to call a special meeting. The committee eliminated these provisions in response to objections voiced during internal committee debates.

5. I.R.C. § 243(a)(1) (1985).

upon the occurrence of a specified event of default and until the corporation cures such default.

(4) Still another variation involves adjustable rate preferred shares. In this variation the dividend rate adjusts periodically either by some automatic formula or at the discretion of the provider of capital in light of changes in some external index of interest rates, such as a bank prime interest rate or the effective interest rate paid by the United States Government on treasury bills or other federal securities.

In some cases attorneys were not entirely certain that Texas corporations could create such novel classes of shares under the Texas Business Corporation Act provisions relating to the creation of new classes of shares.⁶ Of equal practical importance, however, was the view that in publicly held corporations utilizing such modern financing devices the statutes should permit the board of directors to create "series" of securities with these rights without shareholder approval. Sidestepping shareholder approval would avoid the cost of holding a shareholders' meeting to approve each new specific financing. The power of the board of directors to create new "series" of shares under the Texas Business Corporation Act appeared to be narrower than the power to create new "classes" of shares by amendment to the articles of incorporation; amendment, of course, requires a shareholder vote while creation of a "series" does not.⁷

The 1985 amendments squarely address these problems. The legislature amended article 2.12 of the Texas Business Corporation Act relating to classes of shares⁸ to state explicitly that variations in voting rights, including special voting rights, may vary between classes of shares. In addition, the legislature added the following sentence to this article:

Any of the designations, preferences, limitations, or relative rights, including voting rights, of any such class of shares may be made dependent upon facts ascertainable outside the articles of incorporation, provided that the manner in which such facts shall operate upon the designations, preferences, limitations, and relative rights, including vot-

6. TEX. BUS. CORP. ACT ANN. art. 2.12 (Vernon 1980). A corporation could create classes of shares "with such designations, preferences, limitations, and relative rights as shall be stated in the articles of incorporation." *Id.* § A. Article 2.12, § B provides that "without being limited to the authority herein contained, a corporation . . . may issue shares of preferred or special classes . . . subject to the right of the corporation to redeem any shares having a liquidation preference at the price fixed by the articles of incorporation for the redemption thereof." *Id.* § B. Although this language was written in an earlier era and contemplates simpler types of preferred securities, it does not expressly prohibit the novel types of securities described in the text.

7. *Id.* art. 2.13, § C permits the articles of incorporation to authorize the board of directors to create series of shares out of a class of preferred shares. *Id.* § A, however, requires all shares of the class to have identical rights except in seven categories of rights: the rate of dividend, the price at and the terms and conditions on which shareholders may redeem their shares, the amount payable upon voluntary or involuntary liquidation, sinking fund provisions, conversion privileges, and voting rights. The 1985 amendments to these sections not only broadened the provisions relating to the variations in rights between classes of shares, but also made the power of the board of directors to create series virtually as coextensive as the power of the corporation to create classes of shares by amendment of the articles of incorporation.

8. *Id.* art. 2.12, § A.

ing rights, of such class of shares is clearly and expressly set forth in the articles of incorporation.⁹

The legislature amended article 2.13,¹⁰ relating to the power of the board of directors to create series, in more fundamental respects. The same language added to article 2.12 was added to article 2.13. Furthermore, the amendment broadens both the permissible variations in provisions among series and the power of the board of directors to create new series. The amendment to article 2.13 § A also added the following sentence:

The articles of incorporation may provide that the relative rights and preferences of shares of the same class may vary between series in any and all respects, in which case shares of the same class need not be identical so long as all shares of the same series are identical in all respects.¹¹

In addition, the article as amended expressly recognized that as between series the dividend rate, dates, terms, and other conditions with respect to payment and the nature of the dividend (i.e. cumulative, noncumulative, or partially cumulative) may also vary from series to series.¹² A new permissible variation among series allows the corporation to repurchase its obligations with respect to the shares of each series subject to the limitations of article 2.03.¹³

The following provision in article 2.13 significantly broadened the power of the board of directors to create new series of stock, if the articles of incorporation so authorize:

If the articles of incorporation shall expressly vest such authority in the board of directors, then the board of directors shall have authority to establish series of unissued shares of any or all preferred or special classes by fixing and determining the relative rights and preferences of the shares of any series so established within the limitations set forth in this article and in the articles of incorporation, and to increase or decrease the number of shares within each such series; provided, however, that the board of directors may not decrease the number of shares within a series below the number of shares within such series that is then issued.¹⁴

The power of the board of directors to increase or decrease the number of shares of one or more already created series, in particular, is new to Texas jurisprudence. The last clause of the quoted sentence prevents the board from decreasing the number of issued shares of a series below the number of outstanding shares of the series. Presumably, if the corporation has reacquired the shares and holds them as treasury shares, they still constitute

9. *Id.* § A (Vernon Supp. 1986).

10. *Id.* art. 2.13 (Vernon 1980).

11. *Id.* art. 2.13 (Vernon Supp. 1986). This amendment also recognized that the articles of incorporation may restrict the permissible variations between series of shares, and if the articles imposed such a restriction, all shares of the class must possess the same rights consistently with that restriction.

12. *Id.* § A(1)-(2).

13. *Id.* § A(9).

14. *Id.* § B.

issued shares. The corporation will therefore have to cancel them before it may adjust downward the number of shares of that series.

The need for flexibility in the creation of new classes or series of shares to meet financing requirements, however, represents only part of the story. Classes or series of preferred shares also have a much more controversial use. Publicly held corporations that fear an unwanted takeover attempt have developed a variety of novel classes of preferred shares, usually called "poison pills," ingeniously designed to make takeovers more difficult or even impossible. One commonly used "poison pill" greatly increases voting rights of a class of preferred shares in the event a person acquired more than a specified fraction of the corporation's common shares. Another type of "poison pill" grants its holders the right to "put" the shares at a relatively high price to the corporation in the event of a substantial acquisition of the corporation's common shares, or to substitute large amounts of debt securities for the preferred stock in the event of such an acquisition. Still another type of "poison pill" permits a shareholder to acquire shares of the aggressor at a bargain price in the event the aggressor acquires more than a specified fraction of the target's common shares or in the event the aggressor seeks a merger with the target (so-called "cross-over" rights). To say the least, the creation of "poison pills" has been widely publicized, is highly controversial, and is the subject of a great deal of corporate social policy and economic analysis. Courts have questioned their lawfulness in several cases with conflicting results.¹⁵ State law presents one possible source of attack on these

15. The leading cases dealing with the issuance of "poison pills" from the standpoint of the business judgment rule applicable to directors have arisen in Delaware. In *Moran v. Household Int'l, Inc.*, 500 A.2d 1346 (Del. 1985), the Delaware Supreme Court held that the creation of a "poison pill" in advance of any specific takeover threat constituted the exercise of reasonable business judgment. In *MacAndrews & Forbes Holdings, Inc. v. Revlon, Inc.*, 501 A.2d 1239 (Del. 1985), Revlon sought to avoid a takeover by Pantry Pride, a corporation controlled by MacAndrews & Forbes, by entering into "lock up" and "no shop" options with a proposed white knight at prices unfavorable to Revlon. Concluding that the board of directors had changed its role from fending off an unwanted takeover to becoming an "auctioneer" to dispose of Revlon or its various components, the Delaware Supreme Court held that the board's refusal to accept the highest offered price constituted a breach of duty to Revlon's shareholders. *Id.* at 1250-51. A third important case involving a variant of the "poison pill" is *Unocal v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985). Mesa launched a takeover fight against Unocal, a major oil company. Mesa, the owner of 13% of Unocal stock, offered \$54 per share cash for 37% of the remaining stock. Mesa then announced that, if successful, it would acquire the balance of the Unocal stock through a second-step merger in which the remaining holders would receive highly subordinated securities, i.e., securities subordinated to Mesa's extensive borrowings to raise the funds to pay for the 37% of Unocal to be purchased for cash. Unocal responded by offering to repurchase the balance of its shares for debt securities worth \$72 per share if Mesa acquired the controlling shares it sought. The repurchase offer expressly excluded Mesa from its coverage. Unocal's board consisted of eight outside directors and six inside directors. The outside directors met separately with financial advisers and attorneys before the board unanimously approved the proposed transaction. The Delaware Supreme Court upheld this defensive tactic, stating:

In conclusion, there was directoral power to oppose the Mesa tender offer, and to undertake a selective stock exchange made in good faith and upon a reasonable investigation pursuant to a clear duty to protect the corporate enterprise. Further the selective stock repurchase plan chosen by Unocal is reasonable in relation to the threat the board rationally and reasonably believed was posed by Mesa's inadequate and coercive two-tier tender offer. Under these circum-

"poison pills," particularly when the board of directors on its own, without shareholder approval, creates new series of shares that dramatically affect the rights of shareholders and tend to entrench the board in its control of the corporation.¹⁶

The committee of the Texas Bar Association that proposed the amendments to articles 2.12 and 2.13 was clearly aware of the sensitive nature of the "poison pill" issue, and the amendments it proposed appear to validate all such securities from the corporate law standpoint. Presumably questions relating to whether such an issue constitutes a valid exercise of business judgment or is an improper self-dealing transaction will persist in connection with "poison pills" adopted by Texas corporations. The amendments adopted by the Texas Legislature, however, appear to foreclose the argument that only the shareholders may approve a "poison pill" that dramatically reduces the possibility of a successful outside bid for control of the corporation.

B. *Conflict-of-Interest Transactions*

Conflict-of-interest transactions are either transactions between a corporation and one or more of its directors, or transactions between a corporation and another business entity in which one or more of the corporation's directors have a financial interest in the other entity, usually a corporation or partnership.¹⁷ In 1985 Texas became the thirty-ninth state to adopt legislation dealing with this difficult and often sensitive problem.¹⁸

stances the board's action is entitled to be measured by the standards of the business judgment rule.

Id. at 958. If this decision is correct, boards of directors may be able to impose "poison pills" against an already existing aggressor only if they can reasonably conclude that the offer is unfair, inadequate, or coercive.

16. In *Asarco, Inc. v. A Court*, 611 F. Supp. 468 (D.N.J. 1985), the court invalidated a "poison pill" directed at a specific aggressor on the ground that the board of directors did not have power to create a class of shares with voting rights that distinguished between a shareholder with more than 20% of the voting shares and those with less than 20%. *Id.* at 477-78. The board of directors created the poison pill in this case without shareholder consent. It increased the voting power of non-20% shareholders fivefold when a shareholder pierced the 20% level while holding that shareholder to his original voting power. The court intimated that the shareholders may have the power to create such preferred stock by an amendment to the articles of incorporation, but held that the directors could not create such rights on their own. *Id.* at 474. The court also relied on the fact that the board presented the amendment authorizing the board of directors generally to create series of preferred stock to the shareholders solely in terms of permitting the corporation to meet financing needs without having to obtain shareholder approval of amendments. *Id.* at 476; accord *Ministar Acquiring Corp. v. AMF, Inc.*, 621 F. Supp. 1252 (S.D.N.Y. 1985) (board of directors of a target corporation subject to a hostile tender offer exceeded its authority by issuing "rights" to its shareholders. The rights could be exchanged for debentures that would create large amounts of corporate debt and thereby deter tender offers). In *Gearhart Indus., Inc. v. Smith Int'l, Inc.*, 741 F.2d 707 (5th Cir. 1984), the court upheld a "poison pill" debenture/warrant issued by a Texas corporation. *Id.* at 727. The court, however, did not principally address the question whether arts. 2-12 and 2-13 authorized the preferred stock but rather whether the issuance constituted an improper conflict of interest transaction.

17. For a discussion of the Texas law on conflict-of-interest transactions, see 20 R. HAMILTON, *BUSINESS ORGANIZATIONS* §§ 713-714 (Texas Practice 1973).

18. TEX. BUS. CORP. ACT ANN. art. 2.35-1 (Vernon Supp. 1986).

Many self-dealing transactions between a corporation and one or more of its directors undoubtedly benefit the corporation. All corporate lawyers have encountered situations in which a director has made assets available to the corporation at cost, rendered managerial services without demanding compensation, arranged for another business entity controlled by the director to make available goods or services at a favorable price, or cosigned corporate notes to assist the corporation in obtaining needed capital. Usually, the director does not act through altruistic motives but to further his underlying equity interest in the corporation. Nevertheless such transactions obviously benefit rather than harm the corporation. On the other hand, conflict-of-interest transactions often favor the director against the interest of the corporation. This situation will most likely occur when the director has a small or nominal interest in the corporation, so that his own personal gain from the transaction will far outweigh "his share" of the harm to the corporation.

Self-dealing transactions may also occur, however, when the economic interest of the director in the corporation is significant. Corporate lawyers are familiar with situations in which a director with a dominant equity position in the corporation takes in-kind benefits such as expensive automobiles, free lodging or travel, free use of hunting lodges owned by the corporation, or the like. Transactions in which a director unloads assets of dubious value on the corporation for inflated prices may also occur even when the director has a substantial economic interest in the corporation.

Transactions may also occur that fit into neither of these extremes. For example, the director may obtain an independent appraisal of a piece of property and offer it to the corporation at that appraised price, or the entity controlled by the director may sell property to the corporation at list price, the same price at which the director would sell the property to anyone else. In these arm's-length transactions the director treats the corporation in the same way as he treats an unrelated person. The basic problem in the conflict-of-interest area involves segregating the harmful transactions and permitting the corporation to avoid them if they involve abuse of the relationship between director and corporation. The goal is to establish rules that encourage desirable transactions while protecting the corporation from the harmful ones.

The first common law cases during the nineteenth century took the position that all conflict-of-interest transactions were voidable at the option of the corporation.¹⁹ This position has the undesirable effect of discouraging desirable transactions, since the power of rescission may often be exercised with the benefit of hindsight. As a result, the case law that developed during the twentieth century rejected the rule of automatic voidability and based the power of rescission on the fairness of the transaction to the corporation,

19. Marsh, *Are Directors Trustees?*, 22 BUS. LAW. 35, 36 (1966). The language of some Texas cases decided in the early years of this century takes the same position, but those cases involved unfair transactions. See *Canadian Country Club v. Johnson*, 176 S.W. 835, 842 (Tex. Civ. App.—Amarillo 1915, writ ref'd n.r.e.).

coupled with the requirement that a majority of the disinterested directors of a majority of the shareholders approve the transaction.²⁰ Although this rule constituted a distinct improvement over the rule of automatic voidability, it did not adequately deal with some situations. For example: How should a court judge a fair transaction in which all the directors have an interest but which is not submitted to the shareholders and therefore appears voidable without regard to its fairness? When two large, publicly held corporations have one director in common, should all or any business transactions between them be subject to ratification by either or both of the boards of directors? What standards should apply to determine the disinterestedness of a director in family transactions (e.g., may a father who is a director vote on his son's transaction)? Should the law allow shareholders who have an interest in the transaction to vote to ratify that transaction? Should a low-value, arm's-length transaction automatically meet the test of fairness? In 1973 I attempted to encapsulate the Texas common law of conflict-of-interest transactions in the following comments:

[C]onsiderable confusion exists in the case law as to the circumstances which may validate such transactions. If one examines the results of the cases (as contrasted with statements in the opinions), the following comments accurately reflect most of the numerous Texas decisions:

- 1) If the court feels the transaction to be fair to the corporation, it will be upheld;
- 2) If the court feels that the transaction involves fraud, undue overreaching or waste of corporate assets (e.g., a director using corporate assets for personal purposes without paying for them), the transaction will be set aside; and
- 3) If the court feels that the transaction does not involve fraud, undue overreaching or waste of corporate assets, but is not convinced that the transaction is fair, the transaction will be upheld only where the interested director can convincingly show that the transaction was approved (or ratified) by a truly disinterested majority of the board of directors without participation by the interested director or by a majority of the shareholders, after full disclosure of all relevant facts.²¹

Even though these principles explain the results of most of the litigated cases, they do not explain all of them. They also create practical problems. First, the principles are not particularly helpful from the standpoint of the corporation contemplating a desirable conflict-of-interest transaction. Second, the principles do not guide an attorney faced with the problem of giving advice to such a corporation as to how it should approve such a transaction, or whether it can avoid a regretted transaction.

In the modern world conflict-of-interest transactions are more likely to present problems in small or medium-sized corporations than in large, publicly held corporations. Many publicly held corporations have adopted codes of conduct for officers and directors. One of the major purposes of

20. See *Tenison v. Patton*, 95 Tex. 284, 293, 67 S.W. 92, 95 (1902).

21. 20 R. HAMILTON, *supra* note 17, § 714.

these codes is to eliminate all direct conflict of interest transactions.²² In very large, publicly held corporations the most likely conflict-of-interest transactions that arise deal with compensation matters or with arm's-length business transactions between two corporations with a common director. These types of transactions are not likely to involve overreaching. In addition, a large number of other corporations have included in their articles of incorporation or bylaws provisions that seek to deal with conflict-of-interest transactions. These provisions usually purport to approve such transactions as a matter of business judgment and give advance warning to shareholders that the corporation contemplates engaging in such transactions.²³ Courts will not give literal effect to such provisions to validate unfair or fraudulent transactions, but may uphold valid provisions despite possible adverse inferences.²⁴ Because of these codes of ethics and exoneratory clauses, one would expect conflict-of-interest litigation to continue to arise primarily in connection with transactions involving smaller corporations; one would further expect that they would continue to arise with regularity. Surprisingly, although parties have litigated a large number of conflict-of-interest transactions in Texas prior to 1970, the courts have seen virtually no Texas cases of this type in the last fifteen years.

Most statutes dealing with conflict-of-interest transactions have been adopted in the last ten years, primarily based on a Model Business Corporation Act provision added in 1966.²⁵ In 1985 the Texas legislature adopted a statute dealing with such transactions, based on the Delaware provision,²⁶ a statute that is itself similar to the 1969 Model Act provision. The intention of the Bar Committee presumably was to make available to Texas practitioners and Texas courts the Delaware case law construing this new provision since the language adopted by the Texas draftsmen is identical to the Delaware provision.

The statute actually adopted in Texas bears quotation in full:

A. No contract or transaction between a corporation and one or more of its directors or officers, or between a corporation and any other corporation, partnership, association, or other organization in which one or more of its directors or officers are directors or officers or have a financial interest, shall be void or voidable solely for this reason, solely because the director or officer is present at or participates in the meeting of the board or committee thereof which authorizes the contract of transaction, or solely because his or their votes are counted for such purpose, if:

(1) The material facts as to his relationship or interest and as to the contract or transaction are disclosed or are known to the board of direc-

22. See Watt, *Conflicts of Interest—Formalizing the Corporate Policy and Minimizing Exposure to Conflicts of Interest*, 17 BUS. LAW. 42, 43 (1961).

23. See 20 R. HAMILTON, *supra* note 17, §§ 724-725.

24. See *Spiegel v. Beacon Participation*, 297 Mass. 398, 8 N.E.2d 895, 907 (1937).

25. MODEL BUSINESS CORP. ACT § 37(a) (1966). The American Law Institute recodified this section as § 41 of the 1969 Model Business Corporation Act and, in a considerably revised form, as § 8.31 of the 1984 Model Business Corporation Act.

26. DEL. CODE ANN. tit. 8, § 144 (1983).

tors or the committee, and the board or committee in good faith authorizes the contract or transaction by the affirmative vote of a majority of the disinterested directors, even though the disinterested directors be less than a quorum; or

(2) The material facts as to his relationship or interest and as to the contract or transaction are disclosed or are known to the shareholders entitled to vote thereon, and the contract or transaction is specifically approved in good faith by vote of the shareholders; or

(3) The contract or transaction is fair as to the corporation as of the time it is authorized, approved, or ratified by the board of directors, a committee thereof, or the shareholders.

B. Common or interested directors may be counted in determining the presence of a quorum at a meeting of the board of directors or of a committee which authorizes the contract or transaction.²⁷

This statute creates a safe harbor that makes a rule of automatic voidability inapplicable to conflict of interest transactions that meet the requirements of parts (1), (2), or (3) of article 2.35-1, section A. Literally, if a conflict-of-interest transaction satisfies any one of these three parts, the transaction is not void or voidable solely because of the conflict of interest or solely because the interested director was present at the meeting, because he participated in the meeting, or because he voted for the proposed transaction. Since present court-developed law does not impose a rule of automatic voidability, this statute at first blush seems to serve almost no purpose at all. The advantage it provides, however, becomes apparent when one considers the question from the standpoint of getting transactions approved. The standards for approving a transaction under sections A(1), A(2), or A(3) are considerably less onerous than the formal requirements imposed by Texas judicial opinion. For example, under section A(1) a majority of the disinterested directors may validate a transaction if the nature of the transaction is fully disclosed, even though the disinterested directors represent less than a quorum, or in the case of a committee of the board of directors, the committee consists only of a single director.²⁸ Under section A(2) the shareholders may create the safe harbor if the nature of the transaction is fully disclosed, even though the director with the conflict of interest owned all of the shares voted in favor of the transaction.²⁹ Finally, section A(3) validates a transaction that is fair to the corporation even if the interested director makes no disclosure of the material facts, and even if the interested director possesses the decisive vote in approving the transaction. On the other hand, section A(3) literally does not address transactions not passed on by the board of

27. TEX. BUS. CORP. ACT ANN. art. 2.35-1 (Vernon Supp. 1986).

28. *Id.* art. 2.36, § A. Prior to 1973 the only committee contemplated by the statute was an executive committee consisting of two or more members. Texas Business Corporation Act, ch. 64, art. 2.36, 1955 Tex. Laws (amended 1973).

29. Apparently, shares owned by the interested director may be counted. This conclusion follows from a comparison of §§ A(1) and A(2). Section A(1) refers only to disinterested directors, while A(2) refers to "the shareholders entitled to vote thereon" without any indication that interest is a ground for disqualifying any shares. TEX. BUS. CORP. ACT ANN. art. 2.35-1, § A(1)-(2) (Vernon Supp. 1986).

directors, a committee of the board, or the shareholders. For example, a transaction that an officer of the corporation approves without action by the board or by the shareholders is apparently not within the safe harbor of article 2.35-1, section A(3) even if the transaction is fair. One suspects that this example illustrates an oversight rather than an intentional limitation.

The word "solely," used liberally throughout article 2.35-1, makes clear that this article does not attempt to validate all transactions that meet the formal requirements of sections A(1) or A(2). Thus, if a court can set aside a conflict-of-interest transaction because it constitutes fraud or waste, or because it fails to receive approval at a directors' meeting that meets the requirements of the Texas Business Corporation Act,³⁰ the transaction is still vulnerable to attack on those grounds even if it meets the requirements of sections A(1) or A(2).

The juxtaposition of section A(3) as an alternative to sections A(1) or A(2) appears to contemplate that unfair transactions not meeting the requirement of section A(3) may nevertheless be binding on the corporation if the transactions receive approval as required by sections A(1) or A(2); the connective "or" seems clearly to mandate that result. Yet the Delaware case law, presumably imported wholesale by the language of article 2.35-1, flatly rejects this construction. In *Fliegler v. Lawrence*³¹ the Delaware Supreme Court faced a situation in which a conflict-of-interest transaction received approval by a majority of the shares, but the great bulk of the shares voting in favor of the transaction were owned by persons interested in the transaction. The court held that despite this vote the defendants still had the burden of proving the fairness of the transaction.³² If the Texas courts accept this position, as they should, then the prospect of obtaining approval of intrinsically unfair conflict-of-interest transactions by compliance with sections A(1) or (2) would apparently disappear.

What is one to make of this enigmatic and peculiar provision? At best the provision has the legal effect of changing somewhat the rules relating to the procedures corporations must follow to avoid creating a power of rescission of conflict-of-interest transactions. If such transactions are fair and plausibly relate to the corporation's interests, that result is reasonable. The provision also provides a useful directory of minimum procedures that the corporation should normally follow when it considers a conflict-of-interest

30. *Id.* art. 2.31 (Vernon 1980).

31. 361 A.2d 218 (Del. 1976).

32. *Id.* at 222. The court stated:

Defendants argue that the transaction here in question is protected by § 144(a)(2) which, they contend, does not require that ratifying shareholders be "disinterested" or "independent"; nor, they argue, is there warrant for reading such a requirement into the statute. . . . We do not read the statute as providing the broad immunity for which defendants contend. It merely removes an "interested director" cloud when its terms are met and provides against invalidation of an agreement "solely" because such a director or officer is involved. Nothing in the statute sanctions unfairness to Agau or removes the transaction from judicial scrutiny.

Id. (footnote and citation omitted). The court nevertheless stated that the defendants had demonstrated the intrinsic fairness of the transaction in question. *Id.*

transaction: full disclosure of all material facts coupled with consideration by the disinterested directors. Perhaps the statute intended nothing more than this result. But I rather doubt it. The popularity of these safe harbor provisions lies in the belief that, despite the *Fliegler* case, if the transaction meets the procedural requirements of sections A(1) or A(2), then the court will not inquire into the fairness of the transaction. That result, I believe, is undesirable for several reasons discussed below. Certainly a literal reading of the section would appear to contemplate this result.

The development of the conflict-of-interest provision in the 1984 Model Business Corporation Act is instructive, since it probably reflects future developments in this area and illustrates several deficiencies in the new Texas statute. Section 8.31 of the original Exposure Draft, published in March 1983, proposed to follow the California statute dealing with conflict-of-interest transactions.³³ Under California law a court could void such transactions if they were unfair.³⁴ The interested director had the burden of proving that a transaction was not unfair, but if the disinterested directors or shareholders approved the transaction (much as provided in the new Texas statute), the burden shifted to the plaintiff attacking the transaction to show that the transaction was unfair.³⁵ This provision basically codifies the *Fliegler* holding.

The extensive written comments received on various facets of the Exposure Draft criticized the approach taken in the original section 8.31, and as a result the Committee on Corporate Laws directed that the section be returned to the older form—essentially the form taken in the Delaware statute, and now in the Texas statute as well. Even this return, however, did not satisfy several members of the committee, who insisted that the committee consider even further revisions in the way in which the statute treats the conflict-of-interest transaction. The committee has discussed this new revision on several occasions and will probably recommend it for enactment after the *Business Lawyer* publishes it for comment, probably sometime late in 1986.

The proposed Model Act provision basically proceeds on the assumption that the determination by disinterested directors that a conflict-of-interest transaction is desirable should be viewed as a business judgment subject to the protection of the business judgment rule. The proposed Model Act provision, in other words, is a true safe harbor provision, if approved by the disinterested directors, all review of the fairness of the transaction is cut off, though more basic defenses such as fraud, waste, or procedural failures still remain open. As a result, the proposed sections also go to significant lengths to define who is disinterested, covering, for example, family relationships in some detail. I find myself in substantial disagreement with the basic assumption underlying this approach. The suggestion that courts should apply the business judgment rule to transactions or law suits involving co-directors

33. CAL. CORP. CODE § 310 (West 1985).

34. *Id.* § 310(a).

35. *Id.* § 310(a)(3).

assumes a degree of objectivity in directors that may exist in some individuals but certainly does not exist in all of them.³⁶ Some have argued that the theory of small group dynamics reveals that directors will have a systemic bias in favor of other members of the board.³⁷ The proposed Model Act provision, however, applies indiscriminately to all disinterested directors, in closely held corporations as well as publicly held ones. Further, the terms "independent" and "disinterested" are by no means synonymous. A director who is an employee of the corporation may be "disinterested" in a transaction between the CEO and the corporation since he has no financial interest in it, but he is certainly not "independent" in any meaningful sense, since his job may depend on a favorable vote. As a result, the proposed provision leaves open the very real possibility that family or indirect economic ties (not amounting to an interest in the transaction itself) may skew the vote of nominally disinterested directors. This problem becomes considerably more serious as one turns away from the publicly held corporation and considers the closely held family corporation, in which directors are almost never chosen because of the same independence of outlook as are outside directors in the modern, publicly held corporation. Although the proposed Revised Model Act provision on conflict-of-interest goes to some length in defining precisely what is meant by "disinterested," this effort is not likely to avoid unfair results, since in practice the drafting of bright lines always means that the situation just across the line is not covered.

I believe that the Texas legislature should address the following problems with the new Texas statute:

(1) The shares jointly owned or controlled by the directors who have conflicts of interest should be expressly excluded from voting to ratify the transaction.

(2) No decision to approve a conflict-of-interest transaction should be made by a single director; the statute should require the approval of at least two directors. If only a single director is eligible to act on a conflict-of-interest transaction, then in order to receive approval the transaction must meet the requirements of article 2.35-1A, section A(2) or (3).

(3) The statute should expressly codify the *Fliegler* reading of the Delaware provision. This recommendation would require adoption of a provision similar to that of the California provision on conflict of interest.³⁸

36. A similar principle also applies to determinations of the shareholders, but the 1984 Model Business Corporation Act, unlike the Delaware and Texas statutes, excludes the vote of shares owned by persons with an interest in the transaction. MODEL BUSINESS CORP. ACT § 8.31(d) (1984).

37. See Note, *The Propriety of Judicial Deference to Corporate Boards of Directors*, 96 HARV. L. REV. 1894, 1896-97 (1983). Attorneys familiar with the functioning of boards of directors of publicly held corporations usually question whether this conclusion is true in specific cases or generally. See also Cox & Munsinger, *Bias in the Boardroom: Psychological Foundations and Legal Implications of Corporate Cohesion*, 48 LAW & CONTEMP. PROBS. 83, 85-108 (1985) (directors "edit" shareholders' derivative suits and evaluate suits in terms of their own interests rather than corporations).

38. California's conflict of interest statute, codified at CAL. CORP. CODE § 310 (West 1977), provides:

(a) No contract or other transaction between a corporation and one or more of

C. Professional Corporations

Amendments to the Texas Professional Corporation Act during the 1985 legislative session were designed primarily to deal with the increasingly common phenomenon of interstate practice of law, and more precisely, the development of law firms with offices in several states. The most important amendment provides that a "professional legal corporation"³⁹ may be

its directors, or between a corporation and any corporation, firm or association in which one or more of its directors has a material financial interest, is either void or voidable because such director or directors or such other corporation, firm or association are parties or because such director or directors are present at the meeting of the board or a committee thereof which authorizes, approves or ratifies the contract or transaction, if

(1) The material facts as to the transaction and as to such director's interest are fully disclosed or known to the shareholders and such contract or transaction is approved by the shareholders . . . in good faith, with the shares owned by the interested director of directors not being entitled to vote thereon, or

(2) The material facts as to the transaction and as to such director's interest are fully disclosed or known to the board or committee, and the board or committee authorizes, approves or ratifies the contract or transaction in good faith by a vote sufficient without counting the vote of the interested director or directors and the contract or transaction is just and reasonable as to the corporation at the time it is authorized, approved or ratified, or

(3) As to contracts or transactions not approved as provided in paragraph (1) or (2) of this subdivision, the person asserting the validity of the contract or transaction sustains the burden of proving that the contract or transaction was just and reasonable as to the corporation at the time it was authorized, approved or ratified.

A mere common directorship does not constitute a material financial interest within the meaning of this subdivision. A director is not interested within the meaning of this subdivision in a resolution fixing the compensation of another director as a director, officer or employee of the corporation, notwithstanding the fact that the first director is also receiving compensation from the corporation.

(b) No contract or other transaction between a corporation and any corporation or association of which one or more of its directors are directors is either void or voidable because such director or directors are present at the meeting of the board or a committee thereof which authorizes, approves or ratifies the contract or transaction, if

(1) The material facts as to the transaction and as to such director's other directorship are fully disclosed or known to the board or committee, and the board or committee authorizes, approves or ratifies the contract or transaction in good faith by a vote sufficient without counting the vote of the common director or directors or the contract or transaction is approved by the shareholders in good faith, or

(2) As to contracts of transactions not approved as provided in paragraph (1) of this subdivision, the contract or transaction is just and reasonable as to the corporation at the time it is authorized, approved or ratified.

This subdivision does not apply to contracts or transactions covered by subdivision (a).

(c) Interested or common directors may be counted in determining the presence of a quorum at a meeting of the board or a committee thereof which authorizes, approves or ratifies a contract or transaction.

39. TEX. REV. CIV. STAT. ANN. art. 1528e, § 3(d) (Vernon Supp. 1986). Such a corporation is defined as a corporation organized:

for the sole and specific purpose of rendering professional legal service and which has as its shareholders only individuals who themselves are duly licensed or otherwise authorized to render professional legal service and a majority in number and ownership percentage of whom are residents of this state and so

formed under the Texas Professional Corporation Act as long as (a) all of the incorporators and the shareholders are licensed to practice law in Texas or elsewhere, and (b) a majority of the incorporators and a majority of the shareholders who hold a majority interest in the corporation are residents of Texas and are authorized to practice law in Texas.⁴⁰ In effect, this amendment permits attorneys licensed in other states to be a minority of the shareholders of a Texas professional corporation. The legislature also made a minor amendment to section 15⁴¹ to make clear that professional services by a Texas professional corporation outside of Texas need not be rendered by an attorney licensed in Texas.⁴²

The legislature also added a new section to the Texas Professional Corporation Act authorizing a foreign professional corporation engaged in the practice of law to qualify to render professional legal services in Texas if a majority of its shareholders (both in number and in interest) are residents of Texas and authorized to practice law in this state.⁴³ This section expressly requires that professional legal services rendered in Texas by a qualified foreign professional corporation be performed by a person licensed or otherwise authorized to render professional services in Texas. Furthermore, for a foreign legal professional corporation to qualify to transact business in Texas, the state of incorporation of that corporation must grant reciprocal admission to the same corporation if it were incorporated in Texas.⁴⁴

Another statute enacted in 1985 deals with the situation in which the sole shareholder of a professional corporation dies or otherwise becomes legally disqualified to render professional services contemplated by the corporation. In the past only a qualified professional could perform the winding up of a professional corporation's affairs; no provision authorized a nonqualified person entitled to the corporation's assets (e.g., an heir) to wind up the corporation's affairs upon the death or disqualification of the sole shareholder. The legislature amended section 14 of the Texas Professional Corporation Act⁴⁵ to permit the legally disqualified shareholder, or the person succeeding to the interest of the shareholder, to serve as officer, director, and shareholder of the corporation solely to wind up the corporation's affairs and effect its dissolution.

duly licensed or otherwise duly authorized to render professional legal service within this state.

Id. "Professional legal service" is defined as services of an attorney-at-law that, within the State of Texas, require the obtaining of a "license, permit, certificate of registration, or other legal authorization" and which could not be performed by a corporation (prior to the enactment of the Texas Professional Corporation Act). *Id.* § 3(c).

40. *Id.* art. 1528e, §§ 4, 12.

41. *Id.* § 15.

42. On the other hand, the amendment to § 15 discussed in the text appears clearly to require that all professional services rendered by a Texas professional corporation *inside* of Texas be rendered by an attorney licensed in Texas and may not be rendered by an attorney who is a shareholder of the corporation licensed only in another state. *Id.* § 15.

43. *Id.* art. 1528e, § 19A.

44. *Id.* § 19A(b).

45. *Id.* § 14.

D. Registration of Names of Banking and Related Corporations

The legislature amended article 2.07 of the Texas Business Corporation Act⁴⁶ in 1985 to permit a bank, trust company, building and loan association or company, and an insurance company with a valid certificate of authority to transact business in Texas to register their names with the secretary of state under that article for whatever benefit that provides. Article 2.07 was originally derived from the 1950 Model Business Corporation Act.⁴⁷ That section was intended to permit foreign corporations not qualified to transact business in Texas to register their corporate name to assure that that name would be available if the corporation thereafter elected to qualify to transact business in this state. The official comment to sections 9 and 10 of the 1950 Model Business Corporation Act states only that the sections are designed to provide a convenient method for a foreign corporation to reserve its name for a longer time than is permitted by section 8 of the Model Act,⁴⁸ and are "intended" as a convenience for a corporation which plans to extend its area of operations.⁴⁹ In practice section 9 also assured the foreign corporation that no domestic corporation could elect to use the same or a deceptively similar name in a filing with the secretary of state.

Many persons erroneously believe that the registration of a name under article 2.07 gives the registrant some right or entitlement to the use of that name as against the world in general. The only direct advantage of registration, however, is that the name is entered in the list of unavailable names maintained by the office of the secretary of states. That office will not permit another corporation to use the same or a deceptively similar name in a filing with that office. Apparently nothing prevents a corporation named ABC Corporation, for example, from doing business under an assumed name, DEF Corporation, that is identical with the name of another corporation on the list of unavailable names maintained by the office of the secretary of state.⁵⁰ Whether the original DEF Corporation can prevent ABC Corporation from doing business under the name DEF Corporation is a matter of the law of unfair competition. The position of the secretary of state as to whether the names are the same or deceptively similar will presumably carry little weight with a court in view of the limited scope of investigation undertaken by the secretary of state's office. The secretary of state's office does not consider the nature or the scope of the two businesses in question, or the geographical area or areas in which each operates. That office simply compares the names for linguistic identity or similarity, using a set of guidelines

46. TEX. BUS. CORP. ACT ANN. art. 2.07 (Vernon Supp. 1986).

47. See MODEL BUSINESS CORP. ACT § 9 (1950).

48. Section 8 relates to the reservation of a corporate name by a person planning to form a corporation. TEX. BUS. CORP. ACT ANN. art. 2.06 (Vernon 1980).

49. *Id.* § 8.

50. See TEX. BUS. CORP. ACT ANN. art. 2.05, § B (Vernon 1980) (authorizing domestic or qualified foreign corporations to utilize an assumed name upon filing an assumed name certificate).

that that office has formally promulgated.⁵¹ The secretary of state's standard does not seek to determine unfair competition, but rather whether the names are likely to create confusion from the perspective of the secretary of state or by someone using the records of the secretary of state's office.⁵² No Texas court has rendered a definitive decision on this issue, however, and possibly a court may give the secretary of state's determination more weight in an unfair competition case than it would appear to merit.

In Texas, banks, trust companies, building and loan companies, and insurance companies incorporate under special statutes rather than under the Texas Business Corporation Act.⁵³ Since a corporate name cannot contain words or phrases that indicate any purpose other than one or more of the purposes for which the organization was formed,⁵⁴ the original assumption was that there was little chance that a corporation organized under the Texas Business Corporations Act could use a name that might be similar to that of one of these financial corporations. With the onset of deregulation, the development of bank holding companies, and the like, the line (and therefore also the names) between corporations formed under the Texas Business Corporations Act and under banking and similar statutes has probably become less clear. Presumably for this reason bankers in Texas successfully obtained the enactment of this legislation. As indicated above, bankers probably have not gotten very much for their efforts. Certainly if controversies arise over entitlement to name use, the basic remedy should be litigation under such principles as unfair competition and violation of trade mark rather than litigation to compel the secretary of state to refuse a filing.

E. Miscellaneous Provisions

In 1985 the Texas legislature adopted a variety of minor changes to various provisions of the Texas Business Corporation Act designed to improve the efficiency or fairness of certain substantive provisions of that Act. Even though these provisions are minor in a global sense, they will, of course, be of critical importance to attorneys faced with problems in the specific areas. In addition, the legislature made several changes in filing procedures designed both to simplify those procedures and to minimize the unnecessary workload in the corporation section of the secretary of state's office.

1. Required officers. Prior to the 1985 amendments article 2.42, section A of the Texas Business Corporation Act required every corporation to have four officers: a president, one or more vice presidents, a secretary, and a

51. Tex. Office of Sec. of State, 1 TEX. ADMIN. CODE §§ 79.31-.54 (Shepard's Aug. 29, 1987) (corporate name availability).

52. The 1984 Model Business Corporation Act recognized the limited scope of review of corporate names by filing authorities when it changed the standard of review for name availability to consideration of whether the name "is distinguishable upon the records of the secretary of state." MODEL BUSINESS CORP. ACT § 4.01 (1984).

53. TEX. BUS. CORP. ACT ANN. art. 2.01, § B(4) (Vernon 1980).

54. *Id.* art. 2.05, § A(2).

treasurer, though the same person could hold any two or more offices.⁵⁵ The 1985 amendments reduce the number of required officers to two: a president and a secretary.⁵⁶ In contrast, the Revised Model Business Corporation Act⁵⁷ and the Delaware General Corporation Law⁵⁸ do not require any specifically designated officers, although the Model Act does recognize that one officer must perform functions normally associated with the office of secretary.⁵⁹ The theory of these provisions is that corporations should be free to designate the offices they desire. Further, the statutory offices carry with them implications of authority that a corporation may wish to negate, or to give to other designated offices. The Texas Bar Association committee gave consideration to this solution, but technical language in other statutes made it appear desirable to retain at least the two statutory offices.

2. *Filling of Vacancies on the Board of Directors.* In closely held corporations a very common way of assuring minority shareholder participation on the board of directors is to create different classes of common shares, usually with identical financial rights, each entitled to elect a designated number of directors. The creation of classes of common shares to elect directors often reflects a degree of mistrust among the participants in the corporation; otherwise a guarantee that a shareholder could obtain designated representation on the board might not be necessary. Until the 1985 amendments the Texas Business Corporation Act did not adequately handle the problem that arose upon the death or resignation of a director elected by a special class of common shares. Article 2.34 essentially permitted the remainder of the board of directors to fill such a vacancy, even though that method of filling the vacancy did not guarantee the shareholder the designated representation he originally bargained for and, indeed, in cases of actual antagonism, might frustrate completely the original plan.⁶⁰ The 1985 amendments correct this problem by requiring a vacancy in the board of directors selected by a specific class of shares to be filled only by the shareholders of that class or by other directors elected by that class.⁶¹ The amendments extend the same principle to filling newly created directorships.⁶²

3. *Internal Affairs Rule for Foreign Corporations.* The conflict of laws rule for foreign corporations states generally that the law of the state of incorporation governs issues relating to the internal affairs of a corporation. Although most states generally accept the rule, statutory provisions in California⁶³ and New York⁶⁴ purport to apply specific portions of the state's

55. *Id.* art. 2.42, § A (Vernon 1980) (amended 1985).

56. TEX. BUS. CORP. ACT ANN. art. 2.42, § A (Vernon Supp. 1986).

57. MODEL BUSINESS CORP. ACT § 8.40 (1984).

58. DEL. CODE ANN. tit. 8, § 142 (1983).

59. MODEL BUSINESS CORP. ACT §§ 1.40(20), 8.40(c) (1984).

60. TEX. BUS. CORP. ACT ANN. art. 2.34 (Vernon 1980) (amended 1983).

61. *Id.* § D (Vernon Supp. 1986).

62. *Cf.* MODEL BUSINESS CORP. ACT § 8.10(b) (1984) (only holders of shares of stock that elected director can fill that vacancy).

63. CAL. CORP. CODE § 2115 (West 1977) (amended 1978).

64. N.Y. BUS. CORP. LAW § 1319 (Consol. 1963) (amended 1969).

corporation law to foreign corporations with significant contacts in that state. The constitutionality of these provisions remains unclear.⁶⁵ In 1985 the Texas legislature adopted minor amendments to the Texas Business Corporation Act to clarify that Texas did not intend to impose its law upon the internal affairs of foreign corporations qualified to transact business in Texas. Of some interest is the language added to article 8.02 that the internal affairs of a foreign corporation include, but are not limited to, "the rights, powers, and duties of its board of directors and shareholders and matters relating to its shares."⁶⁶

4. *Amendments of the Indemnification Provisions.* In 1983 Texas adopted a modern indemnification statute⁶⁷ modeled upon provisions adopted by the Committee on Corporate laws for the Model Business Corporation Act.⁶⁸ Following the enactment of this complex statute, a few problems cropped up that justified several clean-up amendments:

(a) The language of article 2.02-1, section M, that indemnification provisions not consistent with the statute were void raised the possibility that prestatutory provisions might be unenforceable if they exceeded the permissible scope of statutory indemnification under article 2.02-1 in any minor (or major) respect. In 1985 the language of section M was changed to provide that provisions are "valid only to the extent" a provision is consistent with the statutory standards.⁶⁹

(b) The legislature amended the language of article 2.02-1, sections H and M, to make clear that all rights granted by the statute apply to persons previously named as defendants in a proceeding, those threatened with being named as defendants, and those currently named as defendants.⁷⁰

(c) The legislature amended the language of article 2.02-1, section G, to make clear that the requirement that a corporation authorize indemnification⁷¹ applied only to voluntary decisions to indemnify directors, and not to situations in which indemnification is mandatory by statute or by prior

65. See *Wilson v. Louisiana-Pacific Res., Inc.*, 138 Cal. App. 3d 216, 187 Cal. Rptr. 852, 854 (1983).

66. TEX. BUS. CORP. ACT ANN. art. 8.02 (Vernon Supp. 1986).

67. *Id.* art. 2.02-1, § M. This statute is also analyzed at some length in Hamilton, *Corporations and Partnerships, Annual Survey of Texas Law*, 38 Sw. L.J. 235, 255 (1984).

68. See Committee on Corporate Laws, *Changes in the Model Business Corporation Act Affecting Indemnification of Corporate Personnel*, 36 BUS. LAW. 99 (1980). The 1984 Model Business Corporation Act simplifies and restates these complex provisions although the 1984 version makes no substantive changes. MODEL BUSINESS CORP. ACT ANN. §§ 8.50-.58 (3d ed. 1984).

69. TEX. BUS. CORP. ACT ANN. art. 2.02-1, § M (Vernon Supp. 1986). The new language is consistent with MODEL BUSINESS CORP. ACT ANN. § 8.58(a) (3d ed. 1984).

70. *Id.* These amendments are technical in nature and are consistent with the language of MODEL BUSINESS CORP. ACT § 8.50(2), (6) (1984).

71. A "determination" that indemnification is permissible is distinguished from an "authorization" to indemnify in § G. The same distinction is made in the MODEL BUSINESS CORP. ACT ANN. § 8.55 (3d ed. 1984). In somewhat simplified terms, a determination relates only to eligibility; an authorization is a corporate determination that the payment of indemnification is a desirable and appropriate use of corporate resources.

agreement by which the corporation undertakes to indemnify all persons to the maximum extent permitted by statute.

5. *Simplification of Filing Requirements.* The legislature effected two major simplifications in the formal requirements for documents filed with the secretary of state. First, the legislature eliminated the requirement that a corporation verify the document.⁷² Second, the legislature eliminated the requirement that certain specified officers execute a document intended for filing and replaced it with a simple provision requiring execution by one (unspecified) corporate officer.⁷³ The former requirement had been that the president or vice president and secretary or assistant secretary execute the document.⁷⁴

The elimination of the verification requirement opens up at least the possibility that a corporation might intentionally file false or fraudulent documents with the secretary of state. To impose a penalty on such conduct, the 1985 amendments added article 10.02 to the Texas Business Corporation Act,⁷⁵ making the knowing execution of a false document with intent to file it with the secretary of state a class A misdemeanor.⁷⁶

6. *Amendments to Nonprofit Corporation Act.* Amendments made to the Texas Nonprofit Corporation Act added an indemnification provision analogous to that now appearing in the Texas Business Corporation Act⁷⁷ and a provision to permit telephonic meetings of directors analogous to those permitted by corporations-for-profit.⁷⁸

7. *Recodification of Civil Procedure Statutes.* In a nonsubstantive revision the Texas legislature recodified statutes relating to service of process and venue in the Civil Practice and Remedies Code.⁷⁹ The new section numbers (with the repealed articles of the old civil statutes in parenthesis) are as follows: (1) Sections 17.021 and 17.022 of the new Civil Practice Code now govern service on a partnership (old articles 2033, 2033b, 2033c, and 2223

72. See, e.g., TEX. BUS. CORP. ACT ANN. art. 2.13, § E, art. 4.04, § A, art. 4.07, § D, art. 4.10, § B, art. 4.11, § B, art. 4.12, § B, art. 5.04, § A, art. 6.06, § A, art. 8.05, § B, art. 8.09, § B (Vernon Supp. 1986). Apparently through oversight, the verification requirements for articles of incorporation and for articles of short form merger between parent and subsidiary were not eliminated. See *id.* arts. 3.02, 5.16 (Vernon 1980). Presumably, the next set of amendments prepared by the Texas Bar Association will eliminate the verification requirements for these documents as well.

73. See, e.g., *id.* art. 2.10, § B, art. 2.13, § E, art. 4.04, § A, art. 4.07, § D, art. 4.10, § B, art. 4.11, § B, art. 4.12, § B, art. 5.04, § A, art. 6.06, § A, art. 8.05, § B, art. 8.14, § B (Vernon Supp. 1986). Apparently through oversight, articles of short form merger between parent and subsidiary were not listed. See *id.* art. 5.16, § B (Vernon 1980).

74. Apparently through oversight, article 10.01 was not changed to reflect the 1985 amendments. See *id.* art. 10.01 (Vernon 1980).

75. *Id.* art. 10.02 (Vernon Supp. 1986).

76. TEX. PENAL CODE ANN. § 12.21 (Vernon 1974) makes such an offense punishable by a fine not to exceed \$2,000 or confinement in jail for a term not to exceed one year.

77. TEX. REV. CIV. STAT. ANN. art. 1396-2.22A (Vernon Supp. 1986).

78. *Id.* art. 1396-9.11.

79. Act of June 16, 1985, ch. 959, § 1, 1985 Tex. Sess. Law Serv. 7043, 7053-62, 7079-90 (Vernon).

are repealed);⁸⁰ (2) Section 17.023 of the new Civil Practice Code now governs service on a corporation or joint stock association amenable to process in the state (old article 2029 is repealed);⁸¹ (3) Sections 17.041-17.045 of the new Civil Practice Code now codify the Texas long-arm statute (old article 2031b is repealed);⁸² (4) Section 15.036 of the new Civil Code codified permissible venue of a suit against a domestic corporation or association, including a partnership (old article 1995, § 3(f) is repealed);⁸³ and (5) Section 15.037 of the new Civil Code codified permissive venue of a suit against a foreign corporation (old article 1995, § 3(g) is repealed).⁸⁴ Although the caption of the Act states that this recodification is nonsubstantive, subsequent litigation may reveal possible inadvertent changes in substance.

II. CASE LAW DEVELOPMENT

A. Partnerships

1. *General Analysis.* The Texas courts decided more than fifteen cases dealing with partnership and joint venture issues during the Survey period. Reading all these cases at a single sitting is a rather dismal experience; it reveals that partnership law is not the strongest suit of either the Texas judiciary or the Texas bar. Although an annual survey such as this should concentrate primarily on what the courts did rather than on what they should have done, a few preliminary comments may be helpful in setting forth my own perspective for the benefit of attorneys faced with partnership issues in the future.

The Texas partnership cases during the Survey period revealed two basic jurisprudential problems. First, both the bench and the bar have demonstrated a continuing reluctance to recognize that the law of partnership today is largely codified by uniform statutes.⁸⁵ Obviously, when a statute is directly applicable to a case, the statute should control the decision and reliance on holding or dicta in cases predating the statute that may or may not say the same thing as the statute is unnecessary.⁸⁶ But that is not the Texas way in partnership cases. In most of the partnership cases decided during the Survey period the court preferred to rely on language in pre-statute opin-

80. TEX. CIV. PRAC. & REM. CODE ANN. §§ 17.021, .022 (Vernon Pam. 1986).

81. *Id.* § 17.23.

82. *Id.* §§ 17.041-.45.

83. *Id.* § 15.036.

84. *Id.* § 15.037.

85. TEX. REV. CIV. STAT. ANN. art. 6132b (Vernon 1970) codifies the Texas Uniform Partnership Act. The Texas Uniform Limited Partnership Act, codified at *id.* art. 6132a, was originally patterned after the Uniform Limited Partnership Act (1913), but in response to judicial decisions and uncertainties in that early statute the legislature has substantially amended the statute. These amendments, however, follow to some extent provisions of the Revised Uniform Limited Partnership Act or provisions in other state limited partnership statutes.

86. Even though the Texas Uniform Partnership Act is largely consistent with the pre-1961 Texas common law of partnership, the language in the pre-1961 Texas cases about partnership rules is not always internally consistent, and is not always consistent with the Texas Uniform Partnership Act.

ions. Directly applicable statutory language that should have been controlling was cited as supplementary authority in about half of the cases. In the remaining cases Texas courts resolved partnership issues entirely on the basis of case law without any reference or citation to the applicable statutory provision.⁸⁷ This undesirable state of affairs is presumably the result of the failure of Texas lawyers to cite the controlling statutory provision for the benefit of the court rather than a judge's refusal to apply squarely applicable statutory provisions.

Second, confusion continues as to what legal rules apply to joint ventures as contrasted with partnerships.⁸⁸ In a way this confusion is more difficult to understand than the role of statute and case law, since no general body of joint venture law exists. Furthermore, a joint venture is a species of partnership, a narrow purpose partnership that is subject to the same principles as partnerships except to the extent the narrower purpose provides a justification for a different rule.⁸⁹ A narrow or broad purpose is obviously a matter

87. The Fifth Circuit does not follow the Texas courts in this rejection of relevant statutory law. See *Cates v. International Tel. & Tel. Corp.*, 756 F.2d 1161, 1174 (5th Cir. 1985), in which the court addressed whether the estate of a deceased partner may sue derivatively or in its own right on a partnership claim entirely on the basis of the Texas Uniform Partnership Act. This case is discussed *infra* notes 149-153 and accompanying text.

88. Texas case law defines a joint venture as being based on an express or implied agreement containing four essential elements: (1) a community of interest in the venture, (2) an agreement to share profits, (3) an agreement to share losses, and (4) a mutual right of control or management of the enterprise. *United States v. \$47,875 in United States Currency*, 746 F.2d 291, 294 (5th Cir. 1984) (citing *Coastal Plains Dev. Corp. v. Micrea, Inc.*, 572 S.W.2d 285, 287 (Tex. 1978)). *Micrea* is the leading case in a line of Texas precedent in which parties agreeing to share profits in a joint enterprise were held not liable for the debts of the venture since the parties had no agreement to share losses and therefore no joint venture or partnership existed. See also *Tex-Co Grain Co. v. Happy Wheat Growers, Inc.*, 542 S.W.2d 934, 936 (Tex. Civ. App.—Amarillo 1976, no writ) (sharing of losses is a necessary element in a joint venture); *Gutierrez v. Yancey*, 650 S.W.2d 169, 172 (Tex. App.—San Antonio 1983, no writ) (absence of express provision to share losses indicates no partnership was intended). In the Fifth Circuit case, the court concluded that no joint venture existed because one of the participants had no assets and therefore did not contemplate the sharing of losses. 746 F.2d at 294. With respect, this entire line of precedent is based on unsound principles. A sharing of profits should imply a sharing of losses in the absence of additional factors: persons often are optimistic and discuss expressly the sharing of profits but do not consider the possibility of a sharing of losses. That does not mean that the parties did not create a partnership or joint venture. See TEX. REV. CIV. STAT. ANN. art. 6132b, § 18(1)(a) (Vernon 1970). Also, if a participant has the ownership and control contemplated for the partnership or joint venture relationship, he should be liable for the venture's debts to third parties without regard to any secret internal agreement among the participants as to how they will share losses. A private agreement between *A* and *B*, for example, to operate a business with the profits to be split evenly, but *A* to bear all losses, should nevertheless be viewed as the creation of a partnership or joint venture so that third persons may sue *B* as well as *A*. If the third person compels *B* to pay some liability, *B* has a claim against *A* under the agreement (since *A* agreed that he would assume all the losses), but to argue that *B* is not a partner or joint venturer at all because of the secret agreement between *A* and *B* that *B* would not bear any losses is unrealistic and unsound. In effect, the rights of creditors would be subject to a secret agreement of which the creditors were not aware, in contradiction to the appearance that *A* and *B* are jointly engaged in a partnership or joint venture.

89. For example, the common law rule stated that it was ultra vires for a corporation to enter into a general partnership because the agency principles in a partnership were thought to be inconsistent with the powers of the board of directors in a corporation. It was not ultra vires, however, for a corporation to enter into a joint venture, on the theory that the narrower

of degree and not of kind, and language recognizing this point is scattered throughout the Texas partnership cases decided during the Survey period.⁹⁰ Indeed, the absence of a sharp dividing line between a partnership and a joint venture makes it impractical to maintain different legal rules for the two classes. In the words of one of the modern treatises on agency and partnership:

The joint venture, known variously as joint adventure or joint enterprise, is difficult to adequately describe, differing from a general partnership perhaps more by definition than in fact. It is nevertheless best identified as a special form of partnership in which some limiting factor prevents a complete development of the partnership relation. This limiting factor may take a multitude of forms, ranging from statutory considerations prohibiting operation of certain businesses by partnership to the creation of a business entity which contemplates something less than the mutual agency relation between associates necessary for the existence of a general partnership. Thus, the joint venture, if distinguished from a partnership at all, must be categorized as a business association similar to the partnership but more narrow in purpose and scope.⁹¹

Practically none of the Texas cases decided during the Survey period recognizes expressly this close affinity if not complete identity of legal principles. Some courts appear to accept the notion that joint ventures and partnerships are discretely different animals to be governed presumptively by different rules.⁹²

If Texas courts wish to pursue seriously this dual approach, then it becomes important to define the shadowy line between narrow and broad purposes in order to distinguish between these two types of organizations. The Texas cases, however, do not appear to attempt to do this. Rather the classification of a particular business appears to depend primarily on what name the parties use. If the parties call a venture a "partnership," then the courts will probably apply the common law rules of partnership law, but the same venture, if called a "joint venture" in the agreement, will probably be judged by whatever partially articulated set of rules the court believes to constitute joint venture law.⁹³ Other Texas cases exhibit total confusion or indifference

purpose of that venture limited the power of the remaining venturers to bind the corporation in a manner inconsistent with the powers of the boards of directors.

90. For example, one Texas case decided during the Survey period refers to a "*partnership* formed to carry out a single transaction or venture." *Davis v. Johnson*, 689 S.W.2d 297, 300 (Tex. App.—Houston [1st Dist.] 1985, writ ref'd n.r.e.) (emphasis added).

91. H. REUSCHLEIN & W. GREGORY, *AGENCY AND PARTNERSHIP* § 266 (1979).

92. See, e.g., *Milberg Factors v. Hurwitz-Nordlicht*, 676 S.W.2d 613, 616 (Tex. App.—Austin 1984, writ ref'd n.r.e.) (joint venture and a partnership are not synonymous; many joint ventures are not partnerships even though there may be a sharing of profits; whether a joint venture or partnership exists depends upon parties' intent).

93. Compare *Ked-Wick Corp. v. Levinton*, 681 S.W.2d 851, 858 (Tex. App.—Houston [14th Dist.] 1984, no writ) (court treated as a joint venture an apparently continuing arrangement to build and market new homes) with *Washburn v. Krennek*, 684 S.W.2d 187, 191 (Tex. App.—Houston [14th Dist.] 1984, writ ref'd n.r.e.) (court treated as a partnership an apparently continuing arrangement to subdivide and sell residential lots). The most logical explanation of cases such as these is that in *Ked-Wick* the parties described the arrangement as a joint

in this area. Some courts announce the issue in terms of "joint venture law" but then slide imperceptibly into the use of the word partnership and back again in the same opinion.⁹⁴

Which of these two jurisprudential problems contribute the most to the current malaise of Texas partnership law is unclear, but in tandem they create chaos in an area of law that should be relatively stable and well understood. The strong tendency to treat the law of partnership as common law rather than statutory law makes it relatively easier for the courts also to view the law of joint venture as common law. Both of them are creatures of common law development that may be different in shadow or nuance but similar in some uncertain respects, which the court may flesh out in the best common law tradition of case-by-case analysis. As a result, confusion reigns supreme and uncontradicted in the Texas law of partnership.

A good example during the Survey period of the logical chaos that now exists in Texas partnership joint venture law is *Milberg Factors v. Hurwitz-Nordlicht*.⁹⁵ The issue that the court addressed was whether a joint venturer's creditors may attach the assets of the joint venture as if the venture were merely an aggregate of its venturers.⁹⁶ The alternative was to treat the venture as a distinct legal entity, such as a corporation or partnership, in which case the creditors of an individual member could not reach the assets of that entity. If Texas partnership law had not been marked by the long struggle about whether it consists of statutory or common law and whether joint ventures are a species of partnership, this question should hardly have justified an appeal. The correct answer is that section 28 of the Texas Uniform Partnership Act mandates that an individual creditor may not seize partnership property; he may proceed only through a charging order.⁹⁷ An individual creditor of a partner cannot attach partnership property directly because a contrary conclusion would result in interference with the interests of the other partners. This rationale is totally independent of the scope or breadth of the venture and therefore applies equally to a joint venture—but not in Texas. Because of the total confusion regarding the legal rules applicable to joint ventures in Texas, the creditors argued plausibly and strenuously that since the relationship was a joint venture and not a partnership, the relationship did not involve a separate legal entity. The property interests of joint venturers were therefore akin to the property interests of joint tenants or tenants in common.⁹⁸

venture but in *Washburn* the parties described it as a partnership. Both of these cases are discussed in more detail *infra* notes 119-25 and accompanying text.

94. For example, a case involving two joint ventures to build two apartment buildings refers consistently to the appointment of a receiver to take control of partnership assets. *Smith v. Smith*, 681 S.W.2d 793, 794-96 (Tex. App.—Houston [14th Dist.] 1984, no writ). The explanation for this lack of distinction, may, of course, be that the court was aware that the two categories had no operative difference and therefore regarded the two terms as synonymous.

95. 676 S.W.2d 613 (Tex. App.—Austin 1984, no writ).

96. *Id.* at 615.

97. TEX. REV. CIV. STAT. ANN. art. 6132b, § 28 (Vernon 1979).

98. It is interesting to note in passing, with a touch of *déjà vu*, that this same argument made in connection with partnerships in the nineteenth century led to the development of the English Partnership Act of 1890 and ultimately to the Uniform Partnership Act of 1913.

Fortunately, the court rejected this argument in *Hurwitz-Nordlicht*.⁹⁹ The court based its opinion, however, on a syllogism of inconsistent and irrelevant principles that can only lead to the creation of further problems and uncertainties. The following statements, taken from the court's opinion in the sequence in which they appear, represent perhaps the strongest evidence that the judiciary's view of Texas partnership law needs drastic repair: (1) A joint venture and a partnership are not synonymous; (2) many joint ventures are not partnerships even though there may be a sharing of profits; (3) the relationship of partners and joint venturers is contractual in nature; (4) whether a joint venture or a partnership exists depends in part upon the intention of the parties; (5) a joint venture is a legal entity; (6) the four elements of a joint venture are a community of interest, an agreement to share profits, an agreement to share losses, and a mutual right of control; (7) the requirement of mutual control will not preclude a joint venturer from delegating the duties of management to another joint venturer; (8) here the joint venture agreement provides that it is to be governed by partnership rules; (9) here the debtor had no right to convey the joint venture's property without the consent of his co-venturers; and therefore, (10) "A writ of attachment cannot be had against property of the joint venture since it is not property of the debtor that is subject to execution and not property which the debtor can pass title by his sole act."¹⁰⁰

In the balance of this discussion I turn to the partnership problems addressed by the Texas courts during the Survey period and consider how the courts should resolve them under the Texas Uniform Partnership Act. Generally, the discussion draws no distinction between cases involving joint ventures and partnerships, though when the court categorizes a relationship as one or the other, I follow that categorization.

2. *Formation of a Partnership. Negrini v. Plus Two Advertising, Inc.*¹⁰¹ involved whether a partnership was created preparatory to the formation of a corporation.¹⁰² The parties testified that they always intended to incorporate and that the Negrinis never intended to be personally responsible for the business's obligations. When the Negrinis filed an assumed name certificate, however, the partnership block was checked. Al Negrini testified that since the assumed name certificate did not have a box for corporations, he checked general partnership as the next closest organizational form. The court relied on section 6(1) of the Texas Uniform Partnership Act¹⁰³ and concluded that under all the circumstances, no evidence existed that the Negrinis intended to associate themselves as co-owners in the venture except as shareholders.¹⁰⁴ Therefore, the court held that the Negrinis were not personally liable

99. 676 S.W.2d at 616.

100. *Id.* at 615-16.

101. 695 S.W.2d 624 (Tex. App.—Houston [1st Dist.] 1985, no writ).

102. A second major issue in the case, whether the parties formed the corporation without changing the firm name under TEX. REV. CIV. STAT. ANN. art. 1302-2.02 (Vernon 1970), is discussed *infra* notes 205-06 and accompanying text.

103. TEX. REV. CIV. STAT. ANN. art. 6132b, § 6(1) (Vernon 1970).

104. 695 S.W.2d at 631.

on the plaintiff's claim for advertising commissions.¹⁰⁵

3. *Statute of Frauds Applicable to Partnership Agreements.* *Gano v. Jamail*¹⁰⁶ involved a dispute between a well-known Houston attorney and his former partner. The firm of Jamail and Gano existed from 1969 through 1978 under an oral agreement that Gano claimed provided for an equal division of profits. After the parties terminated their relationship, Gano brought suit to enforce the terms of this alleged oral agreement, but his partner argued that the oral agreement was not enforceable under the Texas statute of frauds¹⁰⁷ since the parties could not perform the agreement within one year. The court basically accepted this argument since the firm's cases generally lasted more than one year and Gano owned a one-half interest in them.¹⁰⁸ From Gano's testimony it became apparent that the oral agreement was to continue until the cases were resolved. The court also held, as an alternative ground, that Gano might be estopped from claiming additional compensation since, during the years of the partnership, he accepted without objection distributions from Jamail that were significantly less than the one-half interest he was claiming in the litigation.¹⁰⁹

4. *Title to Real Property Owned by a Partnership.* In *Nolana Development Association v. Corsi*¹¹⁰ a joint venture owned a large tract of land. The partners sold an interest in this partnership to Manny Corsi. The partnership refinanced the mortgage on the property in connection with the sale and placed title in the name of Ann Corsi, Manny's wife, as trustee to facilitate the refinancing. The name of the joint venture, Nolana Development Association, did not appear on either the note or the accompanying mortgage; title to the real property was simply in the name of Ann Corsi as trustee. The Texas Supreme Court appended the following footnote to the statement of facts in its opinion: "We offer no explanation why the parties conducted their business in this manner. We simply present these curious facts, gleaned from a very limited record."¹¹¹ The court apparently was unaware that the Texas Uniform Partnership Act expressly contemplated this method of recording title to partnership property.¹¹² The Act recognizes the following forms in which title to partnership property may be recorded: (1) in the partnership name; (2) in the name of one or more but not all partners without reference to the partnership; (3) in a third person as trustee for the partnership; and (4) in the names of all the partners.¹¹³ Both the supreme court and the court of appeals¹¹⁴ devoted a large portion of their opinions to the

105. *Id.* at 632.

106. 678 S.W.2d 152 (Tex. App.—Houston [14th Dist.] 1984, no writ).

107. TEX. BUS. & COM. CODE ANN. § 26.01 (Vernon 1968).

108. 678 S.W.2d at 154.

109. *Id.*

110. 682 S.W.2d 246 (Tex. 1984).

111. *Id.* at 248 n.1.

112. TEX. REV. CIV. STAT. ANN. art. 6132b, § 10 (Vernon 1970).

113. *Id.*

114. 674 S.W.2d 874 (Tex. App.—Corpus Christi), *rev'd*, 682 S.W.2d 246 (Tex. 1984).

entirely extraneous question of whether placing title to the property in the name of Ann Corsi as trustee created an express trust subject to the Texas Trust Act, a passive or "dry" trust, or no trust at all. The courts were apparently unfamiliar with the widespread use of nominees to hold title and did not recognize that the form used was a matter of convenience to enable simple conveyance or reconveyance of partnership real estate, as witnessed by the immediate execution of a new mortgage in this case. The court should have recognized that Ann Corsi was simply a holder of naked title and had no obligations to the partnership other than to reconvey the property upon demand. Contemporaneously with placing the title to the real estate in the name of Ann Corsi, however, Manny and Ann Corsi had written a letter to the other partners in which they stated that they were responsible for one-third of the debt. The signature of Ann Corsi did not contain the words "as trustee," and the court concluded that the transaction created a personal obligation on her part to compensate the other co-venturers for the Corsi's share of the loss ultimately incurred on the debt.¹¹⁵ In view of her relationship with Manny Corsi, this conclusion probably was reasonable.

In another case decided during the Survey period¹¹⁶ a joint venture took title to real estate in a similar form: "Sam Wright, Trustee." Sam Wright was also a participant in the venture. The court had no trouble treating this as merely a manner of holding title to real estate by a joint venture without any special significance. The issue was whether the other joint venturers were liable on a promissory note signed by "Sam Wright, Trustee." The court should have resolved this issue by questioning whether the note was within the actual or apparent authority of a partner, an issue addressed in general terms in section 9 of the Texas Uniform Partnership Act.¹¹⁷ The court did not refer to this provision, but concluded that the other venturers were liable because the agreement contemplated the execution of the note. The dissent argued that the court should view the designation "Sam Wright, Trustee," as identical in legal effect to "Sam Wright, Individually." Further, the dissent said that the court should not view Wright as an agent for the remaining joint venturers since he purchased the property and gave the note several months before the joint venture agreement was signed.¹¹⁸ The dissent fails to give any recognition to the natural agency powers created by partnership or joint venture relationships.

5. *Liability for Acts of Co-partners.* In *Ked-Wick Corp. v. Levinton*¹¹⁹ the

115. 682 S.W.2d at 250.

116. *Eggers v. Hinckley*, 683 S.W.2d 473 (Tex. App.—Dallas 1984, no writ).

117. TEX. REV. CIV. STAT. ANN. art. 6132b, § 9(1) (Vernon 1970) states:

Every partner is an agent of the partnership for the purpose of its business, and the act of every partner, including the execution in the partnership name of any instrument, for apparently carrying on in the usual way the business of the partnership of which he is a member binds the partnership, unless the partner so acting has in fact no authority to act for the partnership in the particular matter, and the person with whom he is dealing has knowledge of the fact that he has no such authority.

118. 683 S.W.2d at 479.

119. 681 S.W.2d 851 (Tex. App.—Houston [14th Dist.] 1984, no writ).

court rejected an argument that one co-adventurer was not liable for the negligence of a second co-adventurer in the absence of a showing of control over the actions of that second co-adventurer. The scope of a partner's liability for the acts of his co-partners is set forth in section 9 of the Texas Uniform Partnership Act.¹²⁰ The court did not cite the applicable provisions of the Uniform Partnership Act, but relied on two Texas cases, one decided in 1941¹²¹ and the other in 1956,¹²² for the rule that in a joint venture each party is legally responsible for the act of the other performed within the scope of the enterprise.¹²³ The court therefore reached the correct result. Interestingly, a very similar issue arose in the same court approximately one month later before a different panel of judges.¹²⁴ The later case contained similar facts with two exceptions. First, the parties described the relationship as a partnership rather than a joint venture and second, the breach involved a failure to comply with covenants relating to other land owned by the partners rather than a breach of warranty dealing with materials and workmanship. The court again reached the correct result but failed to cite *Ked-Wick*, the two earlier cases relied on in that case, or the relevant provisions of the Texas Uniform Partnership Act. Rather, the court cited yet a third pre-TUPA case for the same proposition, this time dealing with a partnership rather than a joint venture.¹²⁵

In another case¹²⁶ involving a somewhat similar issue, the court held that a promissory note signed only by a partner in his individual name, without indicating that the note represented a partnership obligation, did not bind the partnership or the remaining partners.¹²⁷ Of course, a partner could quite possibly sign a partnership obligation only in his own name; while somewhat irregular, there should be no objection to viewing the note as a partnership obligation if both parties so understand and the partnership uses the proceeds of the loan for partnership purposes. Since the creditor here obtained separate notes from each partner in an individual capacity for portions of the debt, and the interest rates on the various notes differed, the court's conclusion that the parties intended only an individual obligation is reasonable.¹²⁸

*BancTexas Allen Parkway v. Allied American Bank*¹²⁹ involved a dispute between two banks as to priorities of two liens on partnership assets. The issue essentially was whether a note executed by one partner in the partner-

120. TEX. REV. CIV. STAT. ANN. art. 6132b, § 9(1) (Vernon 1970).

121. *Martin v. Weaver*, 161 S.W.2d 812, 816 (Tex. Civ. App.—El Paso 1941, writ ref'd w.o.m.).

122. *Tex-Jersey Oil Corp. v. Beck*, 292 S.W.2d 803, 809 (Tex. Civ. App.—Texarkana 1956), *modified on other grounds*, 305 S.W.2d 162 (Tex. 1957).

123. 681 S.W.2d at 858.

124. *Washburn v. Krenek*, 684 S.W.2d 187 (Tex. App.—Houston [14th Dist.] 1984, writ ref'd n.r.e.).

125. *Id.* at 191 (citing *Brewer v. Big Lake State Bank*, 378 S.W.2d 948, 951 (Tex. Civ. App.—El Paso 1964, no writ)).

126. *Anderson v. Badger*, 693 S.W.2d 645 (Tex. App.—Dallas 1985, no writ).

127. *Id.* at 648.

128. *Id.*

129. 694 S.W.2d 179 (Tex. App.—Houston [14th Dist.] 1985, no writ).

ship name to cover a bank overdraft bound the partnership.¹³⁰ One would expect that such a note would have at least been within the partner's apparent authority under section 9 of the Texas Uniform Partnership Act, but the court did not cite the statute. Instead the court applied the following test for ratification of an unauthorized transaction: whether the remaining partner knew that the new loan was taken in the partnership name and did not object to its creation.¹³¹ The court found no evidence to show that the other partner even knew of the new loan; therefore, it was not a partnership obligation.¹³²

6. *Liability of Departing Partner for Subsequent Partnership Debts.* In *Thomas v. American National Bank*¹³³ a party in a joint venture entered into an informal agreement with the managing partner¹³⁴ that the managing partner would acquire the party's interest in the venture in exchange for a discharge of the party's share of the venture's indebtedness. After this transaction, the managing partner incurred additional indebtedness in the name of the venture, and the plaintiff brought suit to hold the withdrawing joint venturer liable on this debt. The legal principles applicable to this type of situation are quite clear. Under section 35(1) of the Texas Uniform Partnership Act a withdrawing partner remains liable on subsequently incurred indebtedness to a creditor who extends credit in ignorance of the withdrawal unless the withdrawing partner publishes the notice required by section 35(1)(b).¹³⁵ The court here reached the correct result but did not refer to section 35(1)(b) (though it did refer to section 9(1), dealing with the scope of the agency existing among partners).¹³⁶ The court's discussion creates the appearance that it did not understand the difference between dissolution of a partnership as between the partners, which may occur without more by the express will of any partner at any time,¹³⁷ and elimination of the continuing apparent authority that each partner possesses to bind the partnership and the remaining partners to post-dissolution obligations.

7. *Transactions Antedating the Filing of a Limited Partnership Certificate.* Lawyers forming limited partnerships generally create the limited partnership and file the certificate or limited partnership agreement, as the case may be, before the partners take any steps to enter into business. *Shindler v.*

130. If the note bound the partnership, then BancTexas would have priority under a prior deed of trust containing a standard future advances clause that would cover the note in question.

131. 694 S.W.2d at 181.

132. *Id.* A final case involving the same principle is *MMP, Ltd. v. Jones*, 695 S.W.2d 208 (Tex. App.—Corpus Christi 1985, writ granted), in which the court correctly stated the principle set forth in the Texas Uniform Partnership Act, but relied on a 1974 Texas case followed by a "see also" reference to the applicable statute. *Id.* at 211.

133. 694 S.W.2d 543 (Tex. App.—Corpus Christi 1985, writ granted).

134. In this case both the parties and the court used the words "partner" and "joint venturer" interchangeably.

135. TEX. REV. CIV. STAT. ANN. art. 6132b, § 35 (Vernon 1970).

136. 694 S.W.2d at 550. The court prefaced this citation with the signal "see."

137. TEX. REV. CIV. STAT. ANN. art. 6132b, §§ 31(1)(b), 31(2) (Vernon 1970).

*Marr & Associates*¹³⁸ involved a situation in which one of three general partners of a proposed limited partnership signed a real estate brokerage agreement with the plaintiffs several months before the limited partnership certificate was filed. The other two general partners and the subsequently formed limited partnership resisted liability for the commission due under this agreement on the theory that the limited partnership did not exist, either as a general partnership or as a limited partnership, until the filing occurred. The court quite correctly concluded that the filing served only the purpose of protecting limited partners from liability, and that the partners could and did form a partnership by a simple oral agreement before filing that certificate.¹³⁹ The plaintiffs did not attempt to hold the limited partner liable for the commission owed on the theory that the limited partner, too, became a general partner because of the lack of filing.¹⁴⁰

8. *Liability of Subsequent Partner for Pre-entry Partnership Liability. Simkins v. Outdoor Resorts South Padre Island*¹⁴¹ involved the question whether a person entering a joint venture after an accident involving injury to a third person had occurred was liable to the injured person. Section 17 of the Texas Uniform Partnership Act squarely answers the question. This section provides basically that an incoming partner is liable for such preexisting obligations, but that only partnership property may be used to satisfy the new partner's liability on the judgment.¹⁴² The court noted that the law of partnerships generally govern the duties and liabilities of joint venturers, but then relied on language in two Texas cases that stated the principle of section 17 of the Texas Uniform Partnership Act without citing the applicable statute.¹⁴³ In any event, the court applied the correct principle and reached the proper result.

9. *Fiduciary Duties.* The doctrine that partners in a partnership, or venturers in a joint venture, owe a fiduciary duty to each other in connection with partnership transactions is well established. This duty is set forth expressly in the Texas Uniform Partnership Act¹⁴⁴ and is illustrated by a number of earlier Texas decisions.¹⁴⁵ *Gum v. Schaefer*¹⁴⁶ involved a claim by a partner who, because of personal financial problems, had sold his interest to a co-

138. 695 S.W.2d 699 (Tex. App.—Houston [1st Dist.] 1985, no writ).

139. *Id.* at 704.

140. The court held the limited partner liable apparently under a separate indemnity agreement with the general partners for a portion of the real estate commission. *Id.* The limited partner did not contest its liability under this agreement.

141. 684 S.W.2d 754 (Tex. App.—Corpus Christi 1984, writ ref'd n.r.e.).

142. TEX. REV. CIV. STAT. ANN. art. 6132b, § 17 (Vernon 1970).

143. 684 S.W.2d at 756.

144. TEX. REV. CIV. STAT. ANN. art. 6132b, § 21 (Vernon 1970) provides:

Every partner must account to the partnership for any benefit and hold as trustee for it any profits derived by him without the consent of the other partners from any transaction connected with the formation, conduct, or liquidation of the partnership or from any use by him of its property.

145. The leading Texas case antedating the enactment of the Texas Uniform Partnership Act is *Johnson v. Peckham*, 120 S.W.2d 786 (Tex. 1938).

146. 683 S.W.2d 803 (Tex. App.—Corpus Christi 1984, no writ).

partner with an oral repurchase agreement. The selling partner sued when his co-partner refused to recognize the repurchase agreement. Without referring to the Texas Uniform Partnership Act, but relying on the earlier Texas case law, the court held that the partnership relation imposed as a matter of law a fiduciary duty between partners and that the existence of the fiduciary duty required the purchasing partner to bear the burden of proving the fairness of the sale.¹⁴⁷ Thus, the court created a presumption of unfairness. The court, however, stated that the selling partner would have the burden of establishing the existence of the agreed buy-back commitment as part of establishing his *prima facie* case.¹⁴⁸

10. *Rights of Estate of Deceased Partner. Cates v. International Telephone & Telegraph Corp.*¹⁴⁹ involved the question of the right of an estate of a deceased partner to pursue a partnership claim against the other partners in his own right.¹⁵⁰ The court concluded that although normally the estate would have no direct right under the Texas Uniform Partnership Act to enforce a partnership obligation, the pleadings in this case presented unusual aspects. First, the pleadings asserted that the other partners were in conspiracy with the defendants. Second, the plaintiff claimed that the other partners refused to pursue a partnership claim against the defendants for ulterior, improper motives. The court concluded that Texas law would provide some relief for the estate in this circumstance, possibly including the right to pursue a derivative claim, in addition to the right to sue the co-partners for an accounting.¹⁵¹ The court relied primarily on the language of the Texas Uniform Partnership Act and the case law from other jurisdictions construing the provisions of the Uniform Partnership Act.¹⁵² In the last analysis, however, this case presented a summary judgment issue in which the appellate court concluded that the trial court should not dismiss the plaintiff's colorable claims on procedural grounds before trial so that the plaintiff would never have an opportunity to raise his contentions of fraud, conspiracy, and collusion.¹⁵³

11. *Tortious Interference with At-Will Partnership.* A Fifth Circuit case decided during the Survey period¹⁵⁴ involved the question whether a third person may tortiously interfere with a joint venture agreement that is at will and terminable at any time. Some language in Texas cases indicates that

147. *Id.* at 806.

148. *Id.* at 806-07.

149. 756 F.2d 1161 (5th Cir. 1985).

150. The court also construed some of the claims set forth in the plaintiff's "general, conclusory, and confused" complaint as involving individual claims as well as partnership claims. *Id.* at 1182.

151. *Id.* at 1179. A suit against the conspiring partners individually might be valueless if, for example, the co-partners were judgment proof or the statute of limitations barred the claim against the third parties.

152. *Id.* at 1176-79.

153. *Id.* at 1182.

154. *Deauville Corp. v. Federated Dep't Stores, Inc.*, 756 F.2d 1183 (5th Cir. 1985).

such a claim will not lie.¹⁵⁵ The court, however, concluded that Texas law did not embody a general principle to this effect, pointing to a number of cases in which courts have recognized without discussion such a tortious interference claim to an at-will arrangement.¹⁵⁶

12. *Procedural Issues in Suits by and Against Partnerships.* Several cases basically involved matters of Texas procedure and only indirectly involved partnership law. For example, in *South Texas Aggregates, Inc. v. Pendell*¹⁵⁷ Pendell conducted partnership transactions in his own name. When South Texas Aggregates refused to pay him for some minerals sold to it, Pendell brought suit in his own name on a sworn account. The court of appeals reversed a judgment in Pendell's favor on the ground that Pendell should have brought suit in the name of the partnership rather than in his own name.¹⁵⁸ This rule protects third parties from the possibility of multiple suits, and permits the defendant to answer and file any applicable counter-claims.¹⁵⁹ Since Pendell was the sole manager of the partnership, the efficacy of this rule on the facts of this case seems debatable.

In *Davis v. Johnson*¹⁶⁰ the partnership business encompassed only a single transaction or venture and did not involve any complicated accounts. On these facts the court held that one partner may sue the other partner directly for his interest in the partnership without the necessity of suing for a formal account.¹⁶¹ The Texas Uniform Partnership Act appears to contemplate a formal accounting as the proper method of handling the settlement of all internal partnership claims.¹⁶² The efficacy of the rule set forth by the court seems debatable since the plaintiff may not be able to tell with assurance in advance that no accounting-type issues are present. In the long run the more efficient way to handle this predicament may be to require all plaintiffs to sue for an accounting rather than to recognize a nonstatutory remedy as was done in this case.

In *Thelander v. Moore*¹⁶³ the court faced a situation in which a decree of accounting entered by a trial court purported to resolve the issue of whether a promissory note issued by one partner to another partner was valid and enforceable. The losing party sought a writ of mandamus to compel the trial judge to order a jury trial on this issue. The appellate court refused, stating

155. See *Claus v. Gyorkey*, 674 F.2d 427, 435 (5th Cir. 1982); *Davis v. Alwac Int'l, Inc.*, 369 S.W.2d 797, 801-02 (Tex. Civ. App.—Beaumont 1963, writ ref'd n.r.e.).

156. 756 F.2d at 1195. Cases cited by the court for this proposition include *Diesel Injection Sales & Servs., Inc. v. Renfro*, 656 S.W.2d 568, 573 (Tex. App.—Corpus Christi 1983, writ ref'd n.r.e.) (employment contract); *Panama-Williams, Inc. v. Lipsey*, 576 S.W.2d 426, 434 (Tex. Civ. App.—Houston [1st Dist.] 1978, writ ref'd n.r.e.) (joint venture agreement); *Hampton v. Sharp*, 447 S.W.2d 754, 758 (Tex. Civ. App.—Houston [1st Dist.] 1969, writ ref'd n.r.e.) (employment contract).

157. 694 S.W.2d 608 (Tex. App.—San Antonio 1985, no writ).

158. *Id.* at 610.

159. *Id.*

160. 689 S.W.2d 297 (Tex. App.—Houston [1st Dist.] 1985, writ ref'd n.r.e.).

161. *Id.* at 300.

162. TEX. REV. CIV. STAT. ANN. art. 6132b, § 22 (Vernon 1970).

163. 684 S.W.2d 192 (Tex. App.—Houston [14th Dist.] 1984, no writ).

that the issue of the parties' right to a jury trial should be resolved on appeal rather than by mandamus.¹⁶⁴ Justice Sears concurred, suggesting that the parties should have raised the issue in a separate proceeding rather than by either an appeal or mandamus.¹⁶⁵

13. Receiverships for Partnerships. Two cases decided during the Survey period involved the appointment of receivers for partnerships or joint ventures.¹⁶⁶ In the first case¹⁶⁷ the court appointed a receiver for two apartments held in a joint venture based upon a showing that the managing joint venturer had placed funds in a Swiss bank account in her own name, purchased personal items out of joint venture funds, commingled personal and venture funds, and failed to keep appropriate books and records.¹⁶⁸ In the second case¹⁶⁹ the court ordered a receivership to take control of a herd of cattle to preserve and dispose of the animals in an orderly fashion pending determination of complex issues of ownership among individuals, partners, and creditors of the partnership.¹⁷⁰

14. Miscellaneous Issues. *Kelly Associates v. Aetna Casualty & Surety Co.*¹⁷¹ involved the interpretation of a clause in a "stockholder's blanket bond" that provided that the bond terminated immediately if some other business entity took over the insured's business.¹⁷² The entity involved was a limited partnership consisting of two general and eleven limited partners operating a discount stock brokerage business. In 1981 the general partners, with the consent of the limited partners, transferred much of the partnership's assets to another brokerage firm, only to discover two months later that an employee of the limited partnership had fraudulently embezzled about \$200,000. The transfer of assets and business to the purchaser was a rolling process that culminated in 1982 upon a specified closing date. A majority of the court stated that a "take over" of a business was a phrase susceptible to more than one meaning and construed it in a way most favorable to the insured,¹⁷³ thereby extending bond coverage throughout the winding-up period and covering the claim in question. The dissent argued that the phrase "take over" was a reference to exercise of control and man-

164. *Id.* at 193.

165. *Id.* at 194.

166. TEX. REV. CIV. STAT. ANN. art. 2293 (Vernon 1971) authorizes receiverships in actions "between partners or others jointly owning or interested in any property or fund" in which the applicant's interest is probable and "where it is shown that the property or fund is in danger of being lost, removed or materially injured." *Id.*

167. *Smith v. Smith*, 681 S.W.2d 793 (Tex. App.—Houston [14th Dist.] 1984, no writ).

168. *Id.* at 795.

169. *B & W Cattle Co. v. First Nat'l Bank*, 692 S.W.2d 946 (Tex. App.—Amarillo 1985, no writ).

170. *Id.* at 950.

171. 681 S.W.2d 593 (Tex. 1984).

172. Although the court's opinion does not elaborate, the bond was clearly a "claims made" rather than an "events occurred" bond. In other words, the bond provided coverage only if the claim was made while the bond was in effect, without regard to when the events giving rise to the claim occurred.

173. 681 S.W.2d at 596.

agement, which basically passed to the purchaser upon the sale of the assets by business.¹⁷⁴

B. Corporations

1. *Piercing the Corporate Veil.* Perhaps the most important single case in the corporate law area decided during the Survey period was *Lucas v. Texas Industries, Inc.*¹⁷⁵ The case involved a claim for damages for personal injuries arising from a construction accident. The accident was caused by a concrete beam that had been defectively manufactured by a subsidiary corporation, but the plaintiff brought suit against the parent corporation, thereby creating a classic piercing the corporate veil case.¹⁷⁶ The importance of the case lies not in its holding that the parent corporation was not liable for the subsidiary's negligence, but in the court's opinion, which articulates the legal standards applicable to the doctrine of piercing the corporate veil in a clear and forthright way:

It is important to note at the outset that disregard of the "legal fiction of corporate entity" is an "exception to the general rule which forbids disregarding corporate existence." . . .

. . . Generally, a court will not disregard the corporate fiction and hold a corporation liable for the obligations of its subsidiary except where it appears the corporate entity of the subsidiary is being used as a sham to perpetrate a fraud, to avoid liability, to avoid the effect of a statute, or in other exceptional circumstances. . . . There must be something more than mere unity of financial interest, ownership and control for a court to treat the subsidiary as the *alter ego* of the parent and make the parent liable for the subsidiary's tort. . . . The corporate entity of the subsidiary must have been used to "bring about results which are condemned by the general statements of public policy which are enunciated by the courts as 'rules' which determine whether the courts will recognize their own child." . . . The plaintiff must prove that he has fallen victim to a basically unfair device by which a corporate entity has been used to achieve an inequitable result. . . .

The type of proof needed to satisfy the plaintiff's burden in an *alter ego* case varies depending on whether the underlying cause of action is for breach of contract or tort. . . . Courts have generally been less

174. *Id.* at 597 (Robert, J., dissenting). The dissenting opinion noted that some thefts occurred after the 1981 sale of assets and business. The purchaser's own bond covered these thefts. The dissent argued that this coverage indicated that the parties themselves construed the business to have been taken over upon the sale of assets and business in 1981.

175. 696 S.W.2d 372 (Tex. 1984). The supreme court first decided the case in July, 1984, but petitions for rehearing delayed the publication of the opinion in the *Southwestern Reporter* until October 1985.

176. No evidence showed that the subsidiary corporation was undercapitalized or unable to pay the judgment. The plaintiffs brought suit against the wrong corporation apparently because both corporations used the parent corporation's logo and the parent had delivered the beam to the construction site. The statute of limitations ran before the plaintiffs could enter the correct name. The court noted that the plaintiff did not thereafter attempt to amend his pleadings to substitute the subsidiary corporation as a party defendant under the principle of *Continental S. Lines, Inc. v. Hilland*, 528 S.W.2d 828 (Tex. 1975). 696 S.W.2d at 376.

reluctant to disregard the corporate entity in tort cases than in breach of contract cases. . . .

In a tort case, it is not necessary to find an intent to defraud. Generally, in a tort case the financial strength or weakness of the corporate tortfeasor is an important consideration. . . . If the corporation responsible for the plaintiff's injury is capable of paying a judgment upon proof of liability, then no reason would exist to attempt to pierce the corporate veil and have shareholders pay for the injury. If, however, the corporation sued is not reasonably capitalized in light of the nature and risk of its business, the need might arise to attempt to pierce the corporate veil and hold the parent corporation liable.

The underlying policy argument may be stated as follows: "An inadequately capitalized corporation in a risky business in effect transfers the risk of loss to innocent members of the general public." . . . The financial strength or weakness of the subsidiary is then an important consideration in determining whether the subsidiary is merely a shell through which the parent is conducting its business without taking any of the risks for liabilities incurred.

Unlike in a tort case, however, the plaintiff in a contract case has had prior dealings with the parent corporation. Absent some deception or fraud, the risk of loss is apportioned by virtue of the relative bargaining power.¹⁷⁷

This case rejects flatly a "blending of activities" approach toward parent-subsidiary cases that had obtained some currency among lower state courts and some judges in the Fifth Circuit. The lower court, for example, had submitted a special issue to the jury asking whether it found that the activities of the two corporations had "become so blended that [the subsidiary corporation] for all practical purposes became the alter ego of [the parent corporation]?"¹⁷⁸ The evidence introduced related to such matters as the existence of common officers and directors, the filing of a consolidated tax return, the use of a common corporate logo, the borrowing of money by the subsidiary from the parent, and cooperative efforts in business transactions, including the delivery of beams by the parent corporation to the job site on behalf of the subsidiary. The problem with this blending of activities approach is that it essentially uses no standards and results in the imposition of liability on a parent corporation on almost a random basis for conduct that bears no relationship with the injury suffered by the plaintiff.

The careful distinction between tort and contract cases, and the emphasis on inadequate capitalization in the former but not the latter provides a logical basis for applying the piercing the corporate veil concept, a doctrine that has long been criticized as involving rhetoric and legal conceptualism but little logic or reasoning.¹⁷⁹ The decision furthermore strongly states that in

177. 696 S.W.2d at 374-75 (citations omitted).

178. *Texas Indus., Inc. v. Lucas*, 634 S.W.2d 748, 754 (Tex. App.—Houston [14th Dist.] 1982), *rev'd*, 696 S.W.2d 372 (Tex. 1985).

179. From a personal standpoint the decision in this case is particularly satisfying because it follows an approach that I have long urged. See 19 R. HAMILTON, *supra* note 17, § 234; Hamilton, *The Corporate Entity*, 49 TEX. L. REV. 979, 983-86 (1971).

cases involving voluntary dealing—contracts cases—inadequate capitalization does not provide a sufficient ground for holding a parent liable for its subsidiary's obligations unless the evidence showed deception or fraud amounting to "a basically unfair device by which a corporate entity has been used to achieve an inequitable result."¹⁸⁰

The Dallas court of appeals relied on *Lucas* in reversing a lower court's decision that individual shareholders were personally liable on a contract obligation entered into by their corporation.¹⁸¹ The lower court had charged the jury that they might find the corporation to be the alter ego of the individual shareholders on a variety of factors, including failure to adhere to corporate formalities and the conducting of business "without due regard for the separate corporate nature of the business."¹⁸² The court of appeals held, following *Lucas*, that contract cases required a showing of fraud or bad faith.¹⁸³ It further held that the alter ego issue was a matter of law for the court and that it was erroneously submitted to the jury.¹⁸⁴ Along the same line, in *Roy E. Thomas Construction Co. v. Arbs*¹⁸⁵ the court required the plaintiffs to show that they would suffer harm if the court did not pierce the corporate veil.¹⁸⁶ Furthermore, the plaintiffs must obtain an affirmative jury finding on this question, which involves submitting a special issue to the judge for inclusion in his instructions to the jury.¹⁸⁷

In *Barclay v. Johnson*¹⁸⁸ the court held an officer of a corporation personally liable for fraudulent misrepresentation.¹⁸⁹ The misrepresentations appeared in a letter signed by the officer and reproduced as part of a brochure given to prospective customers. In this situation the court could properly base the liability of the officer on personal participation in the tort and ig-

180. Examples of conduct that might give rise to parental liability for a subsidiary's obligations under *Lucas* include misrepresentation of the assets of the subsidiary by the parent, creation of the impression that the third person is dealing with the parent and then "sliding in" the subsidiary with a similar name at the last minute, the conduct of the subsidiary's affairs so that the subsidiary transfers assets without adequate consideration to the parent, or the conduct of intercorporate transactions at a price that leads to the same result. This listing is of course illustrative and is not intended to be exhaustive. In *Texas Oil & Gas Corp. v. Hagen*, 683 S.W.2d 24 (Tex. App.—Texarkana 1984, no writ), for example, the court found that a purported sale of gas by a parent to a subsidiary was a sham in order to hide the fact that the parent corporation actually sold the gas off premises. Off-premise sales contractually entitled royalty owners to a higher royalty than well-head sales. The court treated the sales by the subsidiary as sales by the parent. *Id.* at 28. *Hagen* does not involve a shareholder's being held liable for a subsidiary's debt. A different test should apply in that case: the overlapping activities and control over the subsidiary's affairs exercised by the parent might justify the court's conclusion that the "subsidiary is simply a name or a conduit through which the parent conducts its business" and that therefore "the corporate fiction may be disregarded in order to prevent fraud and injustice," without regard to the *Lucas* reasoning. *Id.*

181. *Branscum v. Castleberry*, 695 S.W.2d 643, 646 (Tex. App.—Dallas 1985, writ ref'd n.r.e.).

182. *Id.* at 645.

183. *Id.* at 646.

184. *Id.*

185. 692 S.W.2d 926 (Tex. App.—Fort Worth 1985, writ ref'd n.r.e.).

186. *Id.* at 938.

187. *Id.* at 938-39.

188. 686 S.W.2d 334 (Tex. App.—Houston [1st Dist.] 1985, no writ).

189. *Id.* at 338.

nore issues relating to piercing the corporate veil.¹⁹⁰ In a somewhat similar case, the court held a parent corporation liable for injuries to employees of a wholly owned subsidiary because the parent had been negligent in supplying inspection and related safety services to the subsidiary's plant.¹⁹¹

*Zisblatt v. Zisblatt*¹⁹² involved a variation of the piercing the corporate veil doctrine, that is, whether the court should consider the assets of a corporation as community property even though the spouse owned all of the corporation's stock and the corporation existed prior to the creation of the marital community. The leading case of *Vallone v. Vallone*¹⁹³ holds that absent the application of the piercing the corporate veil doctrine, the increase in value of separately held stock does not belong to the community estate. That estate may, however, receive reimbursement for the "community time, talent and labor . . . utilized to benefit and enhance a spouse's separate estate, beyond whatever care, attention, and expenditure are necessary for the proper maintenance and preservation of the separate estate, without the community receiving adequate compensation."¹⁹⁴ The parties in *Vallone* did not properly preserve the possible application of the piercing the corporate veil doctrine, but the court held the doctrine squarely applicable in *Zisblatt*.¹⁹⁵ The husband in *Zisblatt* was a successful manufacturer's representative selling products primarily to airlines and railroads. At the time of his marriage he owned all the shares of Dispo Corporation. Thereafter he arranged his affairs so that Dispo earned all commissions.¹⁹⁶ The corporation owned the family residence, the furniture, and virtually all family assets. In all fairness, a husband should not be able to assign his income-producing potential to a corporation owned as separate property and immunize that potential from the claims of his spouse, and the court so held.¹⁹⁷ In most situations an appropriate valuation of the husband's separate property and the right of the community estate to obtain reimbursement should make resort to this broader argument unnecessary. That was not the case here, however, since the trial court accepted an implausibly low value for the husband's interest in Dispo Corporation, which led to a plainly unfair distribution of the estate.¹⁹⁸

190. The court distinguished a prior holding by the Supreme Court of Texas in *Karl & Kelly Co. v. McLerran*, 646 S.W.2d 174 (Tex. 1983), on the theory that the officer in that case was liable for damages for breach of express warranty by the corporation, and because that kind of case required a showing that the court should ignore the separate existence of the corporation. *Id.* at 337. The *Barclay* court stated that the plaintiffs failed to show that the individuals involved made the express warranties in their personal capacity. 686 S.W.2d at 338.

191. *Johnson v. Able Eng'g Co.*, 749 F.2d 1131, 1133 (5th Cir. 1984). The court relied on the RESTATEMENT (SECOND) OF TORTS § 324A (1966). 749 F.2d at 1133 n.2.

192. 693 S.W.2d 944 (Tex. App.—Fort Worth 1985, no writ).

193. 644 S.W.2d 455 (Tex. 1982).

194. *Id.* at 459.

195. 693 S.W.2d at 953.

196. The evidence indicated that these arrangements were made in contemplation of the ultimate family separation and divorce. *Id.* at 947-48.

197. *Id.* at 958.

198. At the time of the decree, Dispo Corporation had cash or cash equivalents of about \$400,000 with additional receipts of another \$127,000 expected imminently, all allocable to the

2. *Bulk Transfers. Hixon v. Pride of Texas Distributing Co.*¹⁹⁹ involved a novel issue arising under article 6 of the Texas Uniform Commercial Code related in some ways to the piercing the corporate veil doctrine. The defendant purchased all the assets of a corporation that operated a grocery store and continued to operate the business. In this type of situation article 6 provides that the transfer is ineffective against any creditor of the transferor "unless at least ten days before he takes possession of the goods or pays for them" he gives all creditors the bulk transfer notice as required by that article.²⁰⁰ The defendant took possession of the assets on December 3, 1982, but did not give the plaintiff, an unsecured creditor of the grocery store, the required notice until December 8 and again in an amended fashion on December 15. The parties completed the sale on December 27 when checks totalling \$34,500 were delivered to two creditors who held security interests in the assets. The court held the purchaser of the assets liable on the plaintiff's claim.²⁰¹

Since the parties paid over the proceeds of the sale to secured creditors, the defendant argued that section 6.103(3) exempted the transaction from the bulk sale chapter. That section exempts transfers made to settle a lien or security interest.²⁰² Relying on sparse judicial precedents from other jurisdictions, the court held this exemption inapplicable on the ground that plaintiffs introduced no evidence of a default or that the creditors had the immediate right to foreclose on the security interest.²⁰³ Given these facts, the liability imposed on both the shareholders of the selling corporation and on the purchaser of the assets of the corporation might have been avoided by more careful lawyering. Of course, if the required notice had been given, the plaintiff possibly might have taken steps to preserve his status as creditor, steps which he did not take because the transaction occurred without the required notice.

3. *Personal Liability of Officers and Directors for Corporate Obligations.*

(a) *Incorporation Without Change in Firm Name.* An unusual Texas statute provides that when a going business decides to incorporate without a

husband. The total award to the spouse amounted to about \$70,000 in immediately available assets plus a promissory note for \$51,000 payable over ten years. *Id.* at 948.

199. 683 S.W.2d 173 (Tex. App.—Fort Worth 1985, no writ).

200. TEX. BUS. & COM. CODE ANN. § 6.105 (Vernon 1968). This provision is identical to § 6-105 of the Uniform Commercial Code.

201. 683 S.W.2d at 177. The court also held the shareholders of the selling corporation liable for the claim under the common law trust fund doctrine. *Id.* at 176. Texas case law has established that the directors and officers of an insolvent corporation that has ceased doing business must marshal the assets and apply them to the satisfaction of creditors of the corporation. *Lyons-Thomas Hardware Co. v. Perry Stove Mfg. Co.*, 86 Tex. 143, 24 S.W. 16 (1893); *Fagan v. La Gloria Oil & Gas Co.*, 494 S.W.2d 624 (Tex. Civ. App.—Houston [14th Dist.] 1973, no writ). The *Hixon* court did not address whether the trial court properly applied the trust fund doctrine because the court concluded that the issue had not been properly preserved on appeal.

202. TEX. BUS. & COM. CODE ANN. § 6.103(3) (Vernon 1968). This section is identical to § 6-103 of the Uniform Commercial Code.

203. 683 S.W.2d at 178.

change in the business's name, the members of the firm remain liable for corporate debts unless the firm gives notice of intent to incorporate in a newspaper published in the county in which the firm has its principal business office.²⁰⁴ In *Negrini v. Plus Two Advertising, Inc.*²⁰⁵ the Negrinis proposed to operate a restaurant named "The Sea Breeze Restaurant." The plaintiff contracted with Al Negrini to provide advertising services for the new restaurant. A few months later the defendants formed a corporation, "The New Sea Breeze, Inc." The corporation received the plaintiff's first invoice, addressed to The Sea Breeze Restaurant, after the Negrinis had formed the corporation. The corporation made payment to the plaintiff by corporate check. Before becoming insolvent, the corporation actually operated the restaurant under the name "The Sea Breeze Restaurant." The plaintiff testified that he dealt with the Negrinis and that they had not discussed forming a corporation. The Negrinis gave no statutory notice of the change of name. On these facts the court concluded, not unreasonably, that the Negrinis were personally liable on the debt under the statute.²⁰⁶

(b) *Forfeiture of Corporate Privileges.* Another unusual Texas statute provides that if a corporation forfeits privileges for failure to file a report or pay a tax due to the state, then the directors or officers of the corporation incur personal liability for all of the corporation's debts created or incurred after the due date for the report, tax, or penalty, and before corporate privileges are revived.²⁰⁷ Two cases arising during the Survey period involved essentially the same question under this statute. In *Curry Auto Leasing, Inc. v. Byrd*²⁰⁸ an automobile leasing corporation leased an auto to a corporation known as Physician's Accounting Services, Inc. while that corporation still existed. Two years later the corporation defaulted on the lease agreement and the plaintiff repossessed the vehicle. Shortly thereafter the comptroller of public accounts terminated the corporate existence of Physician's Accounting Services, Inc. for the nonpayment of franchise taxes. The automobile leasing corporation then resold the auto to fix its damages under the leasing contract at approximately \$6,500 and sought to hold the officers personally liable under the statute. The court concluded that the individual officers and directors of Physician's Accounting Services, Inc. were not liable for these damages since they had not created or incurred them after the termination of corporate existence.²⁰⁹ The court argued that the liabilities were created or incurred when the automobile leasing agreement was signed,

204. TEX. REV. CIV. STAT. ANN. art. 1302-2.02 (Vernon 1980). This article also provides that actual notice or knowledge of incorporation by a creditor is a defense to the imposition of liability under this section. *Id.*

205. 695 S.W.2d 624 (Tex. App.—Houston [1st Dist.] 1985, no writ). This case is discussed in another context *supra* notes 101-105 and accompanying text.

206. 695 S.W.2d at 629.

207. TEX. TAX CODE ANN. § 171.255(a) (Vernon 1982). Paragraph (b) adds that the liability of a director or officer under this section is "in the same manner and to the same extent as if the director or officer were a partner and the corporation were a partnership." *Id.* § 171.255(b).

208. 683 S.W.2d 109 (Tex. App.—Dallas 1984, no writ).

209. *Id.* at 112.

not when the automobile leasing corporation reduced the damages to a fixed amount or obtained judgment against the corporation for that amount.²¹⁰ Similarly, in *Rogers v. Adler*²¹¹ the plaintiff brought suit for breach of contract, fraud, and violation of the Deceptive Trade Practices Act²¹² against Dycon International Inc. at a time when the corporation was in good standing in Texas. The corporation later forfeited its charter for failing to file reports and pay franchise taxes. Thereafter the plaintiff obtained judgment against Dycon.²¹³ The plaintiff then sought to hold the directors and officers personally liable, basing her claim in tort rather than contract and arguing that the claim was not a debt until reduced to judgment.²¹⁴ The court rejected this rather ingenious argument on the grounds that (1) section 171.255 of the Texas Tax Code is a penal as well as a remedial statute and should be strictly construed to protect those individuals against whom liability is sought, and (2) all of the plaintiff's claims related back to the original creation of the contract and therefore fell within the principle of *Curry Auto Leasing* despite the designation of some of the claims as sounding in tort rather than contract.²¹⁵

(c) *Liability of Officer or Employee for Corporate Actions.* Several cases decided during the survey period involved the problem of whether an officer or employee was jointly or severally liable for his actions on behalf of the corporation. *Leyendecker & Associates, Inc. v. Wechter*²¹⁶ a case involving libel, restated the well accepted principle that an employee who commits a tort while acting within the scope of his employment with a corporation becomes jointly and severally liable with his employer.²¹⁷ In *Retamco, Inc. v. Dixilyn-Field Drilling Co.*²¹⁸ the defendant signed a promissory note in this form:

Retamco, Inc.
By Steve Gose (signed)
Steve Gose (signed)
Individually—Steve Gose²¹⁹

The body of the promissory note, however, referred only to "Retamco, Inc." as the maker. Relying on section 3.118(5) of the Texas Business and Commerce Code²²⁰ and earlier Texas case law,²²¹ the court quite properly held

210. *Id.*

211. 696 S.W.2d 674 (Tex. App.—Dallas 1985, no writ).

212. TEX. BUS. & COM. CODE ANN. § 17.41 (Vernon Supp. 1986).

213. 696 S.W.2d at 675.

214. The plaintiff relief on a definition of debt as "a specified sum of money owing" appearing in *Seay v. Hall*, 677 S.W.2d 19, 23 (Tex. 1984).

215. 696 S.W.2d at 677.

216. 683 S.W.2d 369 (Tex. 1984).

217. *Id.* at 375.

218. 693 S.W.2d 520 (Tex. App.—Houston [14th Dist.] 1985, no writ).

219. *Id.* at 521.

220. TEX. BUS. & COM. CODE ANN. § 3.118(5) (Vernon 1968) provides: "Unless the instrument otherwise specifies two or more persons who sign as maker, acceptor or drawer or indorser and as a part of the same transaction are jointly and severally liable even though the instrument contains such words as 'I promise to pay.'" *Id.*

221. *Seale v. Nichols*, 505 S.W.2d 251 (Tex. 1974).

Gose jointly and severally liable on the note along with Retamco.²²²

In a somewhat more questionable case, *Ross F. Meriwether & Associates v. Aulbach*,²²³ the plaintiff sought service of process on Aulbach, the president of an Illinois corporation, individually, under the Texas long-arm statute.²²⁴ Aulbach filed a special appearance, and the corporate defendant did not contest the existence of jurisdiction. The plaintiff testified that he dealt with Aulbach individually, but the lower court concluded that all dealings had been on a corporate basis and that Aulbach could not be served under the long-arm statute since he had not contracted with a Texas resident.²²⁵ A dissenting opinion argued that this holding confused jurisdiction with liability. According to the dissent, since Aulbach had negotiated with the plaintiff he subjected himself to Texas long-arm jurisdiction and could present the defense that he acted solely as an agent for the corporation at a trial on the merits.²²⁶

Finally, in *Eppler, Guerin & Turner, Inc. v. Kasimir*²²⁷ a law firm hired the plaintiff, an investment banking firm, on behalf of a client. The plaintiff knew that the law firm acted on behalf of a client since the plaintiff styled the letter agreement "Re: Intercontinental Industries vs. The Internal Revenue Service." The agreement provided that the plaintiff should render billings to the law firm, and a senior partner signed the agreement in the name of the law firm. Relying on common law principles, the court concluded that the law firm acted as an agent for a disclosed principal and the case therefore fell within the rule that an agent for a disclosed principal is liable only if it specially undertakes responsibility.²²⁸ The court concluded that the law firm had not undertaken that responsibility.²²⁹ Regardless of whether the court decided this case correctly on its facts, it illustrates the importance to all law firms, when contracting on behalf of a client, to make it clear in the body of the letter agreement that the firm will not be personally liable on the engagement, if that is the intention.

The inherent authority of corporate officers continues to arise in litigation. In a case involving a nonprofit corporation the court held that the president of a police officers association did not have authority to approve a relatively minor amendment to a collective bargaining contract.²³⁰ In another case the court held that the executive vice president of a medical corporation had implicit authority to offer a doctor compensation in part in the form of

222. 693 S.W.2d at 521.

223. 686 S.W.2d 730 (Tex. App.—San Antonio 1985, no writ).

224. TEX. REV. CIV. STAT. ANN. art 2031b (Vernon 1964) (repealed 1985) (recodified at TEX. CIV. PRAC. & REM. CODE §§ 17.061-17.069 (Vernon Pam. 1986)); see also TEX. BUS. CORP. ACT ANN. art. 8.10, § D (Vernon 1980) (all other methods of serving process apply to the Texas Business Corporation Act).

225. 686 S.W.2d at 732.

226. *Id.* at 733.

227. 685 S.W.2d 737 (Tex. App.—Dallas 1985, writ ref'd n.r.e.).

228. *Id.* at 738.

229. *Id.* at 739.

230. *Harrison v. City of San Antonio*, 695 S.W.2d 271, 275 (Tex. App.—San Antonio 1985, no writ).

shares of stock as well as salary.²³¹

4. *Issuance of Stock.* In *Bayoud v. Nassour*²³² a newly formed corporation received a piece of real estate from Nassour equal in value to the capital represented by all shares of stock to be issued by the corporation. The two equal shareholders, however, had not contributed equal amounts toward the purchase of the property; Nassour had contributed \$13,000 toward the purchase while Bayoud had contributed only \$5,000. The parties planned to equal things up by Bayoud's paying \$4,000 directly to Nassour. Bayoud never made this payment, however, and the parties had been almost continually in litigation since the middle 1950s, when the corporation was formed. The current law suit represented an attempt by Bayoud to obtain dissolution of the corporation and appointment of a receiver. Nassour defended on the ground that since Bayoud had never fully paid for his stock, the corporation had not validly issued the stock, and as a result Bayoud was not a shareholder entitled to maintain the suit.²³³

The trial court cancelled a portion of Bayoud's stock to reflect the relative contributions actually made, but the appellate court reversed on the ground that, from the standpoint of the corporation, the full consideration for the stock had been received in the form of the real property.²³⁴ The prohibition against the issuance of partially paid stock was designed to protect the public and bona fide purchasers of stock against watered stock. In other words, the fact that Baoud might owe Nassour the \$4,000 that had never been paid did not affect the validity of the issuance of the original stock for \$18,000 in the form of real property actually received by the corporation.

5. *Liability of Creditors for Interference with Debtor's Affairs.* In one of the more interesting decisions during the Survey period, the court held several banks liable to Farah Manufacturing Company for misuse of the power to accelerate the due date of loans.²³⁵ Farah is, of course, the well-known manufacturer of men's clothing. In the 1970s it was beset with internal labor and management problems, largely focused around the personality of William F. Farah. In 1976 he was replaced as Chief Executive Officer. In 1977 several banks provided working capital for the corporation. The loan agreement contained a standard clause making an event of default any change in the executive management of the corporation that any two banks considered adverse to the interests of the banks. Shortly after the corporation entered into this loan agreement, William Farah began a campaign to regain the Chief Executive Officer position. The banks opposed his return, but their power to

231. *Intermedics, Inc. v. Grady*, 683 S.W.2d 842, 847 (Tex. App.—Houston [1st Dist.] 1985, writ ref'd n.r.e.).

232. 688 S.W.2d 198 (Tex. App.—Eastland 1984, writ ref'd n.r.e.).

233. The court held that the statute of limitations did not prevent Nassour from raising this defense since it was of an "intrinsically defensive nature." *Id.* at 199 (quoting *Morris-Buick Co. v. Davis*, 127 Tex. 41, 43, 91 S.W.2d 313, 314 (1936)).

234. 688 S.W.2d at 200.

235. *State Nat'l Bank v. Farah Mfg. Co.*, 678 S.W.2d 661, 685 (Tex. App.—El Paso 1984, writ dism'd by agr.).

declare his return an event of default was a sort of cataclysmic power that could well have sent the corporation into bankruptcy. Rather than taking a clean position by either accepting his return or declaring a default as authorized by the loan agreement, the lenders decided to send a letter to the board of directors stating that the selection of William Farah was unacceptable and hinting that it might exercise its power to declare a default if the board selected him. The lenders made this threat even more explicit in oral conversations with individual members of the board. As a result, the board did not elect William Farah as CEO. The person chosen was apparently not a wise choice, and the fortunes of the corporation declined precipitously under this new leadership. William Farah finally returned as CEO, and the business picked up almost immediately thereafter. In addition to this intervention in the selection of a CEO, the lenders also used the threat of default either expressly or impliedly to influence the selection of directors and the employment of consultants by the corporation.

The corporation brought suit against the lenders for the financial losses it suffered on theories of fraud, duress, and wrongful interference with business relations. This litigation bristled with difficult legal issues. The first such issue was whether statements concerning what the lenders might do if the board appointed Farah as CEO constituted representations of fact or predictions of future conduct that would be fraudulent only if made when the person had no intention of actually engaging in the conduct. A second issue was whether the lenders' conduct constituted duress when they had expressly reserved the power to engage in the conduct in question and their actions had not previously increased the economic pressures faced by the corporation. Finally, the court examined whether the necessary causal relationships existed between the lenders' conduct and the losses incurred by the corporation that formed the basis of the measurement of damages. The court resolved all of these issues in favor of the plaintiff and entered a judgment in excess of \$18,000,000 on the basis of a jury verdict in favor of plaintiff.²³⁶

6. *Application of the Bangor Punta Doctrine in Texas.* In *Bangor Punta Operations, Inc. v. Bangor & Aroostook Railroad*²³⁷ the United States Supreme Court held that equitable principles precluded a corporation from suing its former owners for waste of corporate assets and mismanagement when outside interests had purchased virtually all of its shares at a fair price. Since the sellers received a fair price for the shares, and any recovery would by definition redound indirectly to the benefit of the new shareholders, the Court held that to permit recovery would give the new owners an unjustified windfall.²³⁸ The correctness of this holding has apparently never been questioned as a general proposition, although the precise grounds of the decision has been the subject of some judicial discussion. Application of the *Bangor*

236. *Id.* at 699.

237. 417 U.S. 703 (1974).

238. *Id.* at 710-11.

Punta doctrine involves ignoring the corporate entity, in a sense, since the court views the corporation's position in connection with the litigation as being the same as its shareholders. The doctrine also may be analogized to the "tainted shares" and "contemporaneous ownership" doctrines applicable in derivative litigation.²³⁹

Texas courts first considered a *Bangor Punta* type of case in *Advanced Business Communications, Inc. v. Myers*.²⁴⁰ Israel, a 48% shareholder of the corporation, purchased for \$200,000 50% of the stock owned by another faction, Myers, Bernabi, and Laws, that controlled the corporation. Italtel S.I.T., a third party, supplied one-half of the price and acquired one-half of the stock sold by Myers, Bernabi, and Laws (25% of the outstanding stock). The corporation later redeemed the Italtel stock so that Israel, at the time of the suit, owned over 99% of the outstanding stock. To complicate matters further, Myers, Bernabi, and Laws warranted in the stock sale agreement that no transactions existed between them and the corporation out of the ordinary course of business.²⁴¹ The plaintiffs alleged that this representation was false to the extent of interest-free loans and unauthorized payments to Myers and Bernabi before the sale of stock, amounting to \$80,000.

These facts differ from those of *Bangor Punta* in part because Israel, the owner of 48% of the stock, ultimately acquired the balance, whereas in *Bangor Punta* over 99% of the outstanding stock had been sold outright to the new owners. The defendants argued that the corporation's suit was totally barred since Israel now owned substantially all of the stock. The corporation argued that *Bangor Punta* did not apply since only 50% of the shares had been sold. The court held that the *Bangor Punta* doctrine was equitable in nature, and that equity required that it be applied pro rata with respect to 50% of the corporation's claim in order to prevent unjust enrichment of either party.²⁴² The corporation also argued that the court should not apply the *Bangor Punta* doctrine to its claim because of the defendants' fraud and breach of warranty. The court rejected this argument, holding that only Israel had a claim based on fraud or breach of warranty, that Israel must present that claim individually, and that the corporation could not interpose the claim to avoid the equitable *Bangor Punta* doctrine.²⁴³ The court also concluded that Israel's failure to seek rescission of the transaction because of

239. The "contemporaneous ownership" doctrine requires the plaintiff to have owned the shares at the time the cause of action arose. The "tainted shares" doctrine provides that if the owner of shares is barred for some reason from maintaining suit, a transferee of the shares is barred also. These doctrines have application by analogy only, since suit is not being brought derivatively by the shareholders, but directly by the corporation.

240. 695 S.W.2d 601 (Tex. App.—Dallas 1985, no writ).

241. Myers, Bernabi and Laws actually made two representations. Clause 10(c) involved a warranty that within a period of six months no direct or indirect transaction between them and the corporation had occurred other than the payment of salaries and reimbursement of reasonable business expenses, all in the ordinary course of business. Clause 10(e) was a more open-ended clause, stating that Myers, Bernabi and Laws had not caused the corporation "to engage in any transaction affecting [the corporation's] business or properties . . . nor has any of them caused [the corporation] to suffer any extraordinary loss." *Id.* at 605.

242. *Id.* at 606.

243. *Id.*

this fraud or breach of warranty did not constitute a waiver of Israel's claim; Israel might seek damages for fraud rather than electing to rescind.²⁴⁴

Next, the court addressed whether to apply the *Bangor Punta* doctrine to the 25% of the outstanding stock that Israel originally acquired from the defendants. The corporation argued that *Bangor Punta* should apply to 25% of the corporation's claim, while the defendants argued that the doctrine should apply on a per share basis, comparing the number of shares Israel purchased with the number of shares he now owned.²⁴⁵ Again viewing the *Bangor Punta* doctrine as an equitable principle, the court concluded that since the nonselling shareholders owned 50% of the corporation the *Bangor Punta* doctrine would not protect the defendants to the extent of 50% of any recovery.²⁴⁶

Finally, the court rejected the defendants' argument that suit should be barred because Israel conceded on deposition that the statement of assets and liabilities furnished to him before he signed the settlement agreement was accurate and that he received essentially the assets and liabilities he expected for his purchase price.²⁴⁷ The court argued that Israel bargained not only for assets and liabilities but also for warranties.²⁴⁸ According to the court:

The fallacy in this argument is that if no withdrawals had been made, the stock sold to Israel would have been more valuable because the \$80,000 withdrawn would have been added and the corporation would have been that much richer. Although Israel may have been content to buy the stock at the price specified if no such unauthorized transactions had occurred, the settlement agreement also warrants to him any benefit he might realize as a stockholder from additional sums due to the corporation as a result of transactions between the corporation and defendants outside the usual course of business.²⁴⁹

The court also pointed out that rejection of this argument was necessary in order for either the corporation or the shareholders to recover for any part of the unauthorized withdrawals.²⁵⁰

7. *Inspection of Books and Records by Shareholders. San Antonio Models, Inc. v. Peeples*²⁵¹ involved the relationship between the statutory right of inspection provided by the Texas Business Corporation Act²⁵² and the right of discovery in litigation. After the plaintiff filed a suit to rescind a stock purchase, the defendant sought to obtain inspection of books and records under article 2.44 by making a demand on the corporation. The corporation

244. *Id.*

245. This difference in formulation led to a significant difference in result because the corporation later repurchased and held as treasury stock the 25% of the stock purchased by Italtel.

246. 695 S.W.2d at 607.

247. *Id.* at 608.

248. *Id.*

249. *Id.*

250. *Id.* at 609.

251. 686 S.W.2d 666 (Tex. App.—San Antonio 1985, no writ).

252. TEX. BUS. CORP. ACT ANN. art. 2.44 (Vernon 1980).

refused this demand on grounds of lack of good faith and proper purpose. Rather than pursuing the demand, the defendant sought information about the corporation's affairs through the litigation discovery process. Among other arguments, the corporation suggested that inspection of the corporation's books and records by discovery in the litigation would deprive it of its right to a jury trial on the issues of good faith and proper purpose in connection with its resistance to the statutory demand for inspection under article 2.44. The court quite properly rejected this argument on the ground that inspection under article 2.44 and discovery in litigation were totally independent and governed by different principles.²⁵³ The Revised Model Business Corporation Act expressly takes the same position as to the scope of the statutory and other rights of inspection.²⁵⁴

A second case, *Accounting Search Consultants, Inc. v. Christensen*²⁵⁵ also involved a procedural question about the right to trial by jury in Texas. In this case the corporation resisted a shareholder's petition for inspection. The trial court ultimately ordered the corporation to deposit \$5,100 into the registry of the court to cover the plaintiff's costs and expenses, including counsel fees, under article 2.44 of the Texas Business Corporation Act.²⁵⁶ The corporation is liable for such costs and expenses under the statute only upon a finding that the expenses were reasonable and necessary. The trial court thereafter ordered the amount to be disbursed to the plaintiff on motion of the plaintiff without a jury trial.²⁵⁷ On appeal the court held this action to be error since the corporation had a right to trial by jury on the issue of whether the expenditures were reasonable and necessary.²⁵⁸

8. *Liability of Corporation for Acts of Officers or Agents.* Several cases decided during the Survey period involved the simple agency question whether the corporate principal was liable for the actions of an officer or agent. In *Kirby v. Cruce*,²⁵⁹ for example, the court allowed defrauded investors in a limited partnership to sue a corporation after accusing the president and secretary-treasury of the corporation of civil conspiracy to defraud.²⁶⁰ The corporation had received interest payments on four transactions and forwarded them to the limited partnership.²⁶¹ In *Hall v. Buck*²⁶² the court held

253. 686 S.W.2d at 670. The court held, however, that the trial judge should first review in camera the information produced in response to broad discovery requests in order to ensure that plainly irrelevant and immaterial information not be produced. *Id.* at 671.

254. MODEL BUSINESS CORP. ACT § 16.02(e)(1) (1984) provides that the statutory right of inspection does not affect the right of a shareholder, if he "is in litigation with the corporation [to inspect records] to the same extent as any other litigant." *Id.*

255. 678 S.W.2d 593 (Tex. App.—Houston [14th Dist.] 1984, no writ).

256. *Id.* at 595-96.

257. *Id.* at 594.

258. *Id.* at 595. The corporation had paid a jury fee at the time the appellee filed the original law suit to compel inspection, long before the court's hearing at which it ordered the disbursement of expenses. The court held this demand timely for a jury trial.

259. 688 S.W.2d 161 (Tex. App.—Dallas 1985, writ ref'd n.r.e.).

260. *Id.* at 165.

261. The major argument in this case did not question the corporation's liability, but rather examined whether the plaintiffs' unclear hands prevented them from suing the corporation and the co-conspirators.

a corporation liable for defamation caused by statements of an executive vice president and office manager that a former employee was a "crook."²⁶³ The issue here was simply whether the corporate officers made the statements within the scope of their employment. Finally, in *National Mar-Kit, Inc. v. Forrest*²⁶⁴ the issue was whether a creditor made a loan to a closely held corporation or to its shareholder. The creditor intended the loan to be to the corporation; however, the creditor made the check payable to the shareholder, who endorsed it to the corporation's account and then withdrew the funds and used them for personal purposes. The corporation argued that it was not liable on the note to the plaintiff since its name did not appear on the note.²⁶⁵ The court rather neatly finessed this argument by holding that the plaintiff sued not on the note but on the underlying obligation.²⁶⁶ It expressly did not pass on the issue whether the president and general manager of a closely held corporation had inherent authority to obligate the corporation on a loan.²⁶⁷

9. *Successor Corporate Liability. Griggs v. Capitol Machine Works, Inc.*²⁶⁸ involved the classic corporate successor products liability case. The plaintiff alleged that he had suffered personal injuries while operating a machine manufactured by a dissolved corporation with the same name as the defendant. Long before the injury occurred, the original Capitol Machine Works, Inc. had dissolved after selling its assets and business to an individual, who subsequently transferred the assets to a newly formed corporation with the same name. The plaintiff brought suit against the dissolved corporation as well as the new corporation named Capitol Machine Works, Inc. The plaintiff did not claim that the new corporation had expressly assumed the liabilities of the original Capitol Machine Works. Rather he based his suit on a "products line" theory adopted in some jurisdictions and rejected in others.²⁶⁹

The court of appeals flatly rejected the doctrine on grounds of both policy and precedent in Texas.²⁷⁰ That this issue should arise at all in a Texas court is in a way surprising since in 1979 the Texas legislature enacted a

262. 678 S.W.2d 612 (Tex. App.—Houston [14th Dist.] 1984, writ ref'd n.r.e.).

263. *Id.* at 619.

264. 687 S.W.2d 457 (Tex. App.—Houston [14th Dist.] 1985, no writ).

265. The court relied on TEX. BUS. & COM. CODE ANN. § 3.401 (Vernon 1968) and the parol evidence rule as explicated in *First State Bank v. Dyer*, 151 Tex. 650, 652, 254 S.W.2d 92, 93 (1953).

266. 687 S.W.2d at 469.

267. *Id.* at 457.

268. 690 S.W.2d 287 (Tex. App.—Austin 1985, no writ).

269. The leading cases accepting this doctrine are *Ray v. Alad Corp.*, 19 Cal. 3d 22, 560 P.2d 3, 136 Cal. Rptr. 574 (1977), and *Ramirez v. Amsted Indus., Inc.*, 86 N.J. 332, 431 A.2d 811 (1981). Cases rejecting the doctrine include *Bernard v. Kee Mfg. Co.*, 409 So. 2d 1047 (Fla. 1982), and *Downtowner, Inc. v. Acrometal Prods., Inc.*, 347 N.W.2d 118 (N.D. 1984). An unsystematic examination of the cases in recent years indicates that the cases rejecting the doctrine appear to be gradually attaining ascendancy, though that may partly be a result of increased sophistication by attorneys involved in structuring transactions that involve a sale of a continuing business.

270. 690 S.W.2d at 293-95.

statute intended to eliminate the possibility of successors to businesses being saddled with liabilities that they had not expressly assumed. Article 5.10, section B of the Texas Business Corporation Act provides:

A disposition of all, or substantially all, of the property and assets of a corporation requiring the [approval] of the shareholders . . .

(2) [e]xcept as otherwise expressly provided by another statute, does not make the acquiring corporation responsible or liable for any liability or obligation of the selling corporation that the acquiring corporation did not expressly assume.²⁷¹

The court referred to this statute in a footnote²⁷² and suggested that it might not be literally applicable to the present case because the operating assets of the dissolved corporation were first transferred to the individual shareholder before being transferred to the defendant. Whether this narrow reading of the statute is correct is debatable; certainly the legislative policy enunciated in 1979 in that statute should have controlled the outcome of the present case if the literal language did not. The court, however, preferred to rest its conclusion on an 1890 decision of the Texas Supreme Court.²⁷³

10. *Attack on Foreign Judgments. Jack H. Brown & Co. v. Northwest Sign Co.*²⁷⁴ involved an Idaho default judgment on which the plaintiff sought enforcement in Texas. The Texas Supreme Court rejected a narrow and technical reading of the return of the service of process in the Idaho case and concluded that the defendant had fair and adequate notice that it was named in the Idaho suit and that the Idaho judgment was therefore entitled to full faith and credit in Texas.²⁷⁵ The facts in the case were complex,²⁷⁶ but the lesson is plain: the court will not set aside default judgments because of

271. TEX. BUS. CORP. ACT ANN. art. 5.10, § B (Vernon 1980). The purpose of this amendment was to overrule the decision in *Western Resources Life Ins. Co. v. Gerhardt*, 553 S.W.2d 783 (Tex. Civ. App.—Austin 1977, writ ref'd n.r.e.). See generally Hamilton, *Corporations and Partnerships, Annual Survey of Texas Law*, 34 Sw. L.J. 321, 233 (1980).

272. 690 S.W.2d at 290 n.2.

273. *Id.* at 293 (citing *Mexican Nat'l Constr. Co. v. Middleage*, 75 Tex. 634, 13 S.W. 257 (1890)). The cited case involved the liability of a successor railroad for injuries to adjoining land that primarily occurred while its predecessor operated a railroad over the same right-of-way. Neither party in *Griggs* cited this case to the court. The case appears to be a rejection of the "products line" approach some eighty-five years before that doctrine first saw the light of day. The "products line" theory rejected by the court in *Griggs* is very similar to the "de facto merger" doctrine. The latter doctrine basically imposes liability on the successor on the basis of policy-oriented analysis rather than more traditional legal analysis.

274. 677 S.W.2d 135 (Tex. App.—Dallas), *rev'd per curiam*, 680 S.W.2d 808 (Tex. 1984), *cert. denied*, 105 S. Ct. 2353, 86 L. Ed. 2d 255 (1985).

275. 680 S.W.2d at 809.

276. *Id.* The case involved two corporations: Signgraphics, Inc., whose registered agent was Jack H. Brown, and Jack H. Brown & Co., whose registered agent was also Jack H. Brown and who also did business under the assumed name of Signgraphics. Service in the Idaho case was made on Jack H. Brown as agent for Signgraphics, but the named defendants included "John Does I through X" doing business as Signgraphics. When this judgment was brought to Texas, a writ of garnishment was served on the account of Signgraphics, Inc. at a Dallas bank. The bank responded that it only had an account styled "Jack H. Brown & Co. d/b/a/ Signgraphics" but no account in the name of Signgraphics, Inc. The plaintiff then went back to Idaho and got the judgment amended to add "Jack H. Brown & Co., d/b/a/ Signgraphics, a Texas corporation" to the judgment in place of "John Doe I."

minor technical variations in naming the defendants. Interestingly, the Texas court in this case based relief on a Texas rule of civil procedure²⁷⁷ to establish that, in Idaho, a party may be identified and sued under the assumed name in which it does business.²⁷⁸

11. Service of Process on Domestic Corporations. The Texas secretary of state has long refused to accept a post office box as the designated address of a registered office of a corporation. The wisdom of this sensible internal rule was well illustrated by a case that arose during the Survey period.²⁷⁹ A plaintiff sought to serve process at a registered office, the address of which turned out to be a post office box furnished by a private postal company. Since personal service could not be made on the registered agent at this address, the constable tried certified mail, but the post office returned the letter without signature. The plaintiff then sought service through the secretary of state under article 2.11, section B,²⁸⁰ but essentially the same thing occurred. The court concluded that it had in personam jurisdiction and upheld the default judgment obtained by plaintiff.²⁸¹ The court commented that it could not come up with any other reasonable alternative method by which the plaintiff could have served the corporation.²⁸²

The other cases dealing with service of process on domestic corporations involved attacks upon default judgments entered upon arguably defective service. In these cases the rule is that in an attack upon a default judgment by writ of error the court may consider only errors on the face of the record.²⁸³ On the other hand, when the defendant may have a plausible defense to the claim on the merits, or even when it does not, the courts are reluctant to enforce the default judgment and cut off all consideration of the merits of the claim. As a result, the rule is well established that even minor errors on the face of the record will permit the court to set aside the default judgment. Perhaps the most extreme case of this type arising during the Survey period was *Cox Marketing, Inc. v. Adams*.²⁸⁴ The court held that a return of service on "Cox Marketing, Inc. by serving Bobby Cox" and service on "Taco Villa, Inc. by serving its registered agent, Bobby D. Cox" were both defective.²⁸⁵ The service on Cox Marketing was defective because the statute authorized service only on a president, all vice presidents, and the registered

277. TEX. R. CIV. P. 28.

278. 680 S.W.2d at 809

279. *Houston's Wild West, Inc. v. Salinas*, 690 S.W.2d 30 (Tex. App.—Houston [14th Dist.] 1985, writ ref'd n.r.e.).

280. TEX. BUS. CORP. ACT ANN. art. 2.11, § B (Vernon 1980) provides that service may be made on the secretary of state as the agent of the corporation whenever "its registered agent cannot with reasonable diligence be found at the registered office."

281. 690 S.W.2d at 32.

282. *Id.*

283. *McKanna v. Edgar*, 388 S.W.2d 927, 929-30 (Tex. 1965).

284. 688 S.W.2d 215 (Tex. App.—El Paso 1985, no writ). This case involved the appeal of a garnishee who had failed to respond to the writ. If the court had upheld the default judgment, the corporation that had been garnished would have been personally liable to the judgment creditor on the debt of a third person, the defendant in the original proceeding.

285. *Id.* at 218.

agent, and the return of service did not indicate the representative capacity, if any, that Bobby Cox had with Cox Marketing.²⁸⁶ The service on Taco Villa, Inc. was defective because the phrase "by serving its registered agent" did not indicate the manner of service as required by the Texas rules.²⁸⁷

In two other cases the court concluded that under the circumstances the record did not show that a "reasonable effort" had been made to serve the registered agent before resorting to service of process on the secretary of state as provided by the Texas Business Corporation Act.²⁸⁸ In *Bilek & Purcell Industries, Inc. v. Paderwerk Gebr. Benteler GmbH & Co.*²⁸⁹ the citation apparently contained an incorrect address for the registered office, but the unexecuted return showed eight entries and several addresses where service could have been attempted. The correct address of the registered office was one of the listed addresses. Without further investigation the plaintiff immediately sought to serve the defendant through the secretary of state under article 2.11, section B. The secretary of state also returned the service unsatisfied, but the court on appeal set aside the default judgment thereafter obtained on the ground that a reasonable effort had not been made.²⁹⁰ In *Beach, Bait & Tackle, Inc. v. Holt*²⁹¹ the court pointed to several procedural defects, including the propriety of sending a Brazoria County constable to serve process in Harris County, and several conclusionary statements in the process server's returns, to set aside a default judgment.²⁹²

The one case upholding a default judgment²⁹³ involved only the straightforward question whether serving the registered agent of a corporation that acts as the registered agent of the defendant is effective service on the defendant. Not surprisingly, the court concluded that such service was effective. All in all, these cases illustrate that courts readily set aside default judgments unless the attorney for the plaintiff makes sure that all procedural details are met and the return accurately describes when and how the plaintiff attempted service.

12. Service of Process under the Texas Long-Arm Statute. A default judgment obtained by substituted service under the Texas long-arm statute²⁹⁴ may also be attacked by writ of error. As with the case of service on a domestic corporation, the regularity of the service must appear on the face of the process and the court will set aside a default judgment for relatively minor or formal deviations. For example, in *Public Storage Properties VII*,

286. *Id.* at 217.

287. *Id.* at 218 (citing TEX. R. CIV. P. 107).

288. TEX. BUS. CORP. ACT ANN. art. 2.11, § B (Vernon 1980).

289. 694 S.W.2d 225 (Tex. App.—Houston [1st Dist.] 1985, no writ).

290. *Id.* at 226.

291. 693 S.W.2d 684 (Tex. App.—Houston [14th Dist.] 1985, no writ).

292. *Id.* at 685-86.

293. *National Medical Enters. v. Wedman*, 676 S.W.2d 712 (Tex. App.—El Paso 1984, no writ).

294. TEX. REV. CIV. STAT. ANN. art. 2031b (Vernon 1964) (repealed 1985) (recodified at TEX. CIV. PRAC. & REM. CODE §§ 17.061-17.069 (Vernon Pam. Supp. 1986)).

*Ltd. v. Rankin*²⁹⁵ the court set aside a default judgment based on service under article 2131b because the complaint alleged that the defendant had a mailing address in Georgia, but did not allege that the defendant was a foreign corporation or a nonresident natural person.²⁹⁶ The court also found the pleading defective because it did not allege whether the defendant was a corporation.²⁹⁷ Furthermore, an allegation that the defendant "has not maintained a registered agent" did not satisfy the requirement that the petition allege that the defendant "does not maintain a place of regular business in this State."²⁹⁸ These kinds of deviations between the statutory requirements and the actual allegations of a complaint reflect sloppy lawyering, which in this case caused the client the cost of an unnecessary and losing appeal.

*Kawasaki Steel Corp. v. Middleton*²⁹⁹ presented a more interesting and more substantive case. Kawasaki, a Japanese steel company, sold steel to a Texas resident through an independent Japanese trading company. At the time of the transaction Kawasaki maintained an office in Houston, Texas, although it had not formally qualified to transact business in Texas. About two months before process was served in this case Kawasaki formed a New York subsidiary, Kawasaki America, and transferred all United States offices and employees in those offices to that subsidiary. Kawasaki America qualified to transact business in Texas, using the same address and telephone number that the Japanese corporation had formerly used. The company simply transferred the office manager and the other employees without any significant change in appearance in the offices. When the third-party filed the complaint, it alleged that Kawasaki was a New York corporation and service of process could be obtained on the registered agent at the Houston address. In other words, the plaintiff sought service of process under the Texas Business Corporation Act for a qualified foreign corporation³⁰⁰ rather than under old article 2031b for an unqualified corporation.³⁰¹ The office manager promptly forwarded copies of the process to the defendant in Japan as well as the New York offices of the subsidiary.

After Kawasaki filed a special appearance, the question arose whether it could attack the method of service of process or only its amenability to suit. Concluding that Kawasaki had sufficient contacts with Texas to subject it to the jurisdiction of the state,³⁰² the court ordered a remand with instructions that Kawasaki Steel Corporation would be deemed to have entered its ap-

295. 678 S.W.2d 590 (Tex. App.—Houston [14th Dist.] 1984, no writ).

296. *Id.* at 592.

297. *Id.*

298. *Id.* at 593.

299. 699 S.W.2d 199 (Tex. 1985).

300. TEX. BUS. CORP. ACT ANN. art. 8.10 (Vernon 1980).

301. TEX. REV. CIV. STAT. ANN. art. 2031b (Vernon 1964) (repealed 1985) (recodified at TEX. CIV. PRAC. & REM. CODE § 17.061-17.069. (Vernon Pam. Supp. 1986)).

302. The evidence supporting this conclusion set forth in the opinion persuasively shows that subjecting Kawasaki to suit in Texas was consistent with the principles of cases such as *U-Anchor Advertising, Inc. v. Burt*, 553 S.W.2d 760 (Tex. 1977).

pearance in accordance with Texas Rule of Civil Procedure 122.³⁰³ The serious issue as to the propriety of service of process, according to the court, could not be raised on a special appearance, but could thereafter be raised on motion to quash service, presumably following the remand.³⁰⁴

The final state case to arise during the Survey period, *Beechem v. Pippin*,³⁰⁵ contained a rather elaborate theoretical discussion about the limits of due process based on leading decisions of the Supreme Court of the United States.³⁰⁶ The facts involved a negotiation between a Texas resident and a Georgia corporation for the rental of a machine by the Georgia corporation. A representative of the Georgia corporation began the negotiations with the Texas resident over the phone. The plaintiff accepted the written contract in Texas, and the defendant made payments to the owner of the machine in Texas. On these facts the court concluded that it was constitutionally permissible to require the Georgia defendants to defend in Texas.³⁰⁷ The fact that the defendants owned real and personal property in Texas and had engaged in unrelated business transactions in Texas also influenced the court.³⁰⁸

In a federal case, *Maurice Pierce & Associates v. Computerage, Inc.*,³⁰⁹ the court dismissed a suit brought in federal court in reliance on article 2031b.³¹⁰ In this case the contacts on which the plaintiff asserted jurisdiction consisted of acts of a promoter of the defendant and of another foreign corporation. The court considered theories of agency, control or alter ego, and ratification, but concluded that none of them justified the assertion of jurisdiction.³¹¹

303. 699 S.W.2d at 202; see TEX. R. CIV. P. 122.

304. 699 S.W.2d at 202.

305. 686 S.W.2d 356 (Tex. App.—Austin 1985, no writ).

306. *Helicopteros Nacionales de Colombia, S.A. v. Hall*, 466 U.S. 408 (1984); *Worldwide Volkswagen Corp. v. Woodson*, 444 U.S. 286 (1980); see Brilmayer, *How Contacts Count: Due Process Limitations on State Court Jurisdiction*, 1980 SUP. CT. REV. 77, 87.

307. 686 S.W.2d at 363.

308. *Id.*

309. 608 F. Supp. 173 (N.D. Tex. 1985).

310. *Id.* at 176.

311. *Id.* at 176-77.