



1977

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Recommended Citation

John J. Kendrick Jr., *Corporations*, 31 Sw L.J. 205 (1977)
<https://scholar.smu.edu/smulr/vol31/iss1/8>

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CORPORATIONS

by

John J. Kendrick, Jr.*

THE survey period saw no dramatic changes made in the Texas law affecting corporations. The Texas courts, however, did decide interesting cases dealing with the corporate opportunity doctrine, rights of dissenting shareholders, piercing the corporate veil, corporate liability, corporate creditors, and securities. This Article will examine these areas.

I. GENERAL CORPORATE DEVELOPMENTS

Corporate Opportunity Doctrine. In *Canion v. Texas Cycle Supply, Inc.*¹ the Texas court of civil appeals considered the difficult area of the corporate opportunity doctrine. The corporate opportunity doctrine comes into play when an employee enters into a business transaction which could have been utilized by the corporation itself. In this case the president of the corporation learned that the owner of the property leased by the corporation was having financial problems. He discussed with the vice president, who was the sole shareholder of the corporation,² whether the corporation should purchase the property which was to be sold at a trustee's sale. The vice president later attended that sale and purchased the property, but in his own name, rather than the corporation's name. The corporation itself was subsequently placed in receivership and the receiver filed suit to cancel the deed to the vice president and declare that the real estate was owned in fee simple by the corporation. In addressing the issue of corporate opportunity generally, the court stated that when a business opportunity is within the scope of the corporation's activities, and is one in which the corporation has a legitimate interest or expectancy, the opportunity belongs to the corporation, and, when an officer or director diverts that opportunity to his own benefit, he is chargeable as a constructive trustee and holds the property and all of the profits and benefits therefrom for the corporation.³ A corporation's financial inability to take advantage of an opportunity is one of the defenses which may be asserted in a suit involving an alleged appropriation of a corporate opportunity, but the burden of pleading and proving the corporate inability should be placed upon the officer or director who allegedly appropriated the corporate opportunity.⁴ The court of civil appeals, in reversing the trial court's holding which had found a constructive trust, expressed "difficulty in understanding how an officer and director of a corporation, who is its sole shareholder, may appropriate a corporate opportunity of his solely owned

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1. 537 S.W.2d 510 (Tex. Civ. App.—Austin 1976, writ ref'd n.r.e.).

2. There was some evidence in the case, as pointed out in the dissenting opinion, that the vice president was not the sole shareholder. *Id.* at 514-15 (Phillips, C.J., dissenting).

3. *Id.* at 513; *see, e.g.*, *International Bankers Life Ins. Co. v. Holloway*, 368 S.W.2d 567 (Tex. 1963).

4. *See Huffington v. Upchurch*, 532 S.W.2d 576 (Tex. 1976) (dealing with the misappropriation of a partnership opportunity).

corporation."⁵ The court went on to state, however, that even assuming that the vice president had usurped a corporate opportunity, he had, as its only stockholder, ratified that act.⁶ This decision begs the issue, since the corporate opportunity, if really an asset of the corporation, would be available to creditors of the corporation as well as its shareholders.

Dissenting Shareholders. The necessity of strict compliance by corporations with the statutory requirements dealing with dissenting shareholders was the topic of discussion in *Parkview General Hospital, Inc. v. Waco Construction, Inc.*⁷ Article 5.13(B) of the Texas Business Corporation Act⁸ requires any dissenting shareholder who demands payment for his shares under article 5.12 to submit his shares to the corporation within twenty days after making such demand. A shareholder's failure to do so, "at the option of the corporation," terminates his rights under article 5.12 unless good cause is shown.⁹ In *Parkview General Hospital* a shareholder who objected to a sale of the corporation's assets failed to submit his share certificates within the twenty-day period. The defendant corporation, however, did not object to the shareholder's untimely submission and admitted in its pleadings that the shareholder had complied with the statutory requirements. The court of civil appeals held that by these actions the corporation had expressly waived any objection to the shareholder's late tender, thus allowing the shareholder to continue to claim the rights given him under article 5.12.¹⁰ The case clearly demonstrates that a corporation must act affirmatively to terminate the rights of a dissenting shareholder who fails to tender his shares within the statutory time period.¹¹

Piercing the Corporate Veil. The area of piercing the corporate veil was again the subject of litigation during 1976.¹² Generally, the courts are unwilling to disregard the corporate entity and treat it as the alter ego of an individual unless it is shown that there is such unity of interest and ownership that the individuality of the corporation and the owner or owners of its stock have ceased and that the observance of the fiction would sanction fraud or promote injustice. In addition, some form of bad faith must be shown before the court will disregard the fiction of separate corporate existence.¹³ It is incumbent upon the party seeking to pierce the corporate veil to show by the evidence that the financial structure of the corporation is just a sham and accomplishes an injustice.¹⁴ In *Holmes v. Clow*¹⁵ plaintiff brought suit against the corpora-

5. 537 S.W.2d at 513.

6. *Id.* at 514.

7. 531 S.W.2d 224 (Tex. Civ. App.—Corpus Christi 1976, no writ).

8. TEX. BUS. CORP. ACT ANN. art. 5.13(B) (Vernon Supp. 1976-77).

9. *Id.*

10. 531 S.W.2d at 228-29.

11. For a procedural guide to compliance with the statutory requirements see 2 H. KENDRICK & J. KENDRICK, TEXAS TRANSACTION GUIDE § 20.08[2] (1976).

12. *Holmes v. Clow*, 533 S.W.2d 99 (Tex. Civ. App.—Tyler 1976, no writ). For a discussion of the concept of separate corporate existence see Hamilton, *The Corporate Entity*, 49 TEXAS L. REV. 979 (1971).

13. *Holmes v. Clow*, 533 S.W.2d 99, 106 (Tex. Civ. App.—Tyler 1976, no writ); see *Hollywood Cleaning & Pressing Co. v. Hollywood Laundry Serv.*, 217 Cal. 124, 17 P.2d 709 (1932).

14. *Holmes v. Clow*, 533 S.W.2d 99, 105 (Tex. Civ. App.—Tyler 1976, no writ).

15. *Id.*

tion and its president to recover for certain blueprinting and design work he had done for a housing project which was to be constructed by defendant corporation. The plaintiff contended that the corporation was the alter ego of its president and that the president was thus individually liable for the debts of the corporation. The individual defendant and his wife functioned as the president and secretary of the corporation and also constituted two of three members of its board of directors. The president-defendant owned two-fifths of the corporation's stock and had individually signed promissory notes in order that the business could obtain substantial loans. In addition, the corporation had paid certain credit accounts and bills that were in the president's individual name. In light of these facts the court of civil appeals held that there was not sufficient evidence to require a holding that, as a matter of law, the corporate entity should be disregarded. In doing so, the court emphasized that the problem of determining whether the corporate entity ever existed, and if it did, whether it ceased to exist, was primarily a task for the trier of fact and not a question of law.¹⁶ This area of the law receives much attention but the factual nature of the inquiry prevents meaningful guidelines from being established.

Corporate Liability. Three cases during the survey period involved the legal responsibility of a corporation for actions of its employees. In *Wagner v. Caprock Beef Packers Co.*¹⁷ the plaintiff, a former employee of the corporation, brought suit against the corporation and the general manager of one of its facilities for slander. After plaintiff had voluntarily terminated his employment with defendant corporation and had applied for employment elsewhere, the general manager telephoned from the corporation's premises the personnel managers of three of plaintiff's prospective employers and falsely told them that he was an alcoholic. The Supreme Court of Texas¹⁸ relied on the criterion developed in *Texam Oil Corporation v. Poynor*¹⁹ in determining the corporation's liability. That standard imposes liability on the corporation only when the defamation is referable to a duty owed by the agent to the corporation and was made while the agent was in the discharge of that duty. Noting that there had been no showing that the general manager was authorized to communicate information about ex-employees to prospective employers and that it was unusual for such unsolicited information to be given in the particular industry, the court held that there was no factual basis for the inference that the general manager's communications were within the scope and course of his employment.²⁰ Thus, the corporation was not liable for the slander.

16. *Id.* at 106.

17. 540 S.W.2d 303 (Tex. 1976).

18. Prior to reaching the supreme court a jury verdict had been rendered against the defendant corporation in the trial court. That judgment was reversed by the court of appeals on the basis that there was no evidence to support a finding that the general manager was acting in the course and scope of his employment when he slandered plaintiff. *Caprock Beef Packers Co. v. Wagner*, 531 S.W.2d 194 (Tex. Civ. App.—Amarillo 1975), *aff'd*, 540 S.W.2d 303 (Tex. 1976).

19. 436 S.W.2d 129 (Tex. 1968).

20. 540 S.W.2d at 305. The dissenting opinion concluded that such an inference was possible, emphasizing that a general manager is "often an extremely powerful individual clothed

*Ledisco Financial Services, Inc. v. Viracola*²¹ involved a suit by a debtor to recover damages, both actual and exemplary, for unreasonable efforts by defendant corporation in the collection of a debt.²² The corporation had been employed by Carte Blanche to retrieve a cancelled credit card from the debtor. To accomplish the retrieval, an agent of the corporation went to the debtor's home and requested the return of the card. This visit resulted in a physical confrontation²³ and an alleged assault by the agent upon the debtor. In addition, the debtor alleged that subsequent to this visit the agent made threatening telephone calls to his home, using obscene language²⁴ and refusing to identify himself.²⁵ The jury rendered a verdict against defendant corporation with damages of \$7,500 for the harassing telephone calls, \$1 for the physical assault, and \$10,000 in exemplary damages.²⁶ This judgment was reversed by the court of civil appeals²⁷ which held that the corporation was not liable for the acts of its agent in handling the nonpaying customer. With regard to the telephone calls, the court noted that there was no evidence showing that the officers of the corporation had authorized the calls or that there was anything said in the calls for the purpose of prompting the debtor to return the credit card. In light of the absence of evidence on these factors, the court concluded that the calls were motivated solely by the agent's personal anger and desire to retaliate for the physical confrontation.²⁸ Thus, the corporation was not acting through its agent in the telephone calls. The holding on this issue would have been sufficient to reverse the trial court, but the court went on to address the issue of exemplary damages. In strong judicial dictum the court said that a corporation can be held liable for exemplary damages only when it is shown that:

- (1) the agent who acted with malice is something more than a mere servant; in other words, an agent who represents the corporation in such a manner that his acts are regarded as the acts of the corporation itself, or
- (2) the malicious act of a servant was previously authorized or subsequently adopted or ratified by the corporation, or (3) the corporation could reasonably have anticipated that what it knew the servant would do would likely cause him to maliciously do some other wrong.²⁹

The corporation also escaped liability for the wrongful actions of its employee in *Arabesque Studios, Inc. v. Academy of Fine Arts, Inc.*³⁰ In that case a former employee of plaintiff breached a covenant not to compete

with substantial authority" and usually empowered to give and receive personnel references. *Id.* at 306-07 (McGee, J., dissenting).

21. 533 S.W.2d 951 (Tex. Civ. App.—Texarkana 1976, no writ).

22. See TEX. REV. CIV. STAT. ANN. art. 5069, §§ 11.01-.11 (Vernon Supp. 1976-77).

23. See *id.* art. 5069, §§ 11.02(a), .02(h) which prohibits debt collectors from using or threatening to use violence or any action prohibited by law.

24. See *id.* art. 5069, § 11.03(a) which prohibits the use of obscene language in debt collection.

25. See *id.* art. 5069, § 11.03(b) which makes telephone calls made by debt collectors, without disclosure of their identity, unlawful.

26. 533 S.W.2d at 954.

27. *Id.* at 951.

28. *Id.* at 956.

29. *Id.* at 957. See generally *Fort Worth Elevators Co. v. Russell*, 123 Tex. 128, 70 S.W.2d 397 (1934); *Fort Worth Hotel Co. v. Waggoman*, 126 S.W.2d 578 (Tex. Civ. App.—Fort Worth 1939, writ *dism'd jdgmt cor.*).

30. 529 S.W.2d 564 (Tex. Civ. App.—Dallas 1976, no writ).

contained in their prior employment agreement. The covenant specified that the employee, a dance instructor, would not engage in the same or similar employment within five miles of any of plaintiff's business locations for twelve months after termination of her employment or teach any of plaintiff's current customers during that time.³¹ In violation of the agreement the employee began providing dance instruction for the defendant corporation within four months of the date she terminated her association with the plaintiff. The Dallas court of civil appeals held that the corporate employer who hired the employee was not liable for a breach of the employment agreement with the prior employer. The second employer could not be held liable on a breach of contract theory since there was no privity of contract between the two employers and no evidence that the second employer ratified or confirmed the employee's breach of the agreement with the former employer.³² The knowledge of the employee could not be imputed to the employer since the knowledge of an agent cannot be imputed to a principal if the agent has a personal adverse interest in not revealing it.³³ The court also refused to hold the defendant corporation liable for tortious interference with the contractual relationship between the employee and her former employer since it was not demonstrated that the second employer actually caused or brought about the interference. The court stated that it is not enough that the second employer "merely reaped the advantages of a broken contract after the contracting party had withdrawn from the commitment on his own volition."³⁴

Corporate liability for the wrongful acts of a company's retirement committee was discussed in *Ennis Business Forms, Inc. v. Gehrig*.³⁵ In that case a former employee brought an action to recover for the termination of disability retirement benefits provided under a company plan. The plaintiff had been Ennis' chief executive officer when he suffered a mental and emotional breakdown. After he was forced into retirement by the company's board of directors, plaintiff received disability benefits under the company's plan for thirty months. The plan provided for disability payments up to sixty-six months if, in the opinion of the retirement committee, the former employee remained unable to return to work. The plan expressly provided that the assets of the plan's trust fund were the sole means to satisfy a claim for benefits and that the company, its employees, officers, or agents would never be liable for such benefits.³⁶

All contributions to the retirement plan were made by the company, were irrevocable, and were transferred to the trust fund. None of the contributions were made by the employees. The fund was invested and administered by a trustee appointed by the company in accordance with a trust agreement between the company and the trustee. Moreover, the administration and responsibility for carrying out the plan was in the hands of the retirement committee consisting of five persons appointed by the company's directors to serve at the directors' pleasure.

31. *Id.* at 566.

32. *Id.* at 567-68.

33. *Id.* at 568.

34. *Id.*

35. 534 S.W.2d 183 (Tex. Civ. App.—Waco 1976, writ ref'd n.r.e.).

36. *Id.* at 185-86.

On appeal from the trial court's judgment for the employee, the court of civil appeals was presented with the question of whether the judgment against the company could stand in light of the contractual provision making only the trust fund liable for wrongfully terminated benefits. The court reviewed the nature of the fund, its sole source of contributions, and the composition of the retirement committee. Emphasizing that the fund was administered by a trustee appointed by the company, that all contributions to the plan were made by the company, and that the retirement committee was appointed by the company's directors, the court held that the trust fund was merely an extension of the company.³⁷ Thus, the judgment was not improper because it was solely against the company.

Corporate Creditors. After obtaining a judgment lien, corporate creditors often discover that the debtor no longer has any assets. The plaintiffs in *Noble v. Marcus*,³⁸ after encountering this problem, attempted to enforce their lien against property that the corporation had previously conveyed to the defendants.³⁹ An employee of the debtor had executed a warranty deed conveying the corporate property by signing as vice president of the corporation, although in actuality he did not occupy that office. The judgment creditor attempted to set aside the deed, alleging forgery and fraud by the employee.

The court of civil appeals affirmed the trial court's grant of the defendant's motion for a summary judgment, holding that the plaintiffs lacked standing because they had failed to plead that they had been the victims of a fraudulent conveyance.⁴⁰ The Texas Supreme Court affirmed the judgment, but found that the appellate court had erred in grounding its opinion on fraudulent conveyances, since the creditors' pleading was based upon an alleged fraud committed against the debtor corporation.⁴¹ The court noted that a deed obtained by fraud is not void but merely voidable at the election of the grantor and that only the defrauded party can maintain an action to set aside a deed obtained by fraud.⁴² Thus, the court held that the plaintiffs lacked standing because they were not the defrauded party but only creditors of the allegedly defrauded party.⁴³

The message of *Nobles* is clear: when a corporate creditor believes that the assets of the debtor have been conveyed in order to prevent foreclosure of his judgment lien the proper action is neither a suit for fraud nor a suit for forgery. The creditor should instead bring an action for fraudulent conveyance,⁴⁴ and allege that the conveyance was made to prevent him from reaching the debtor's property.

37. *Id.* at 190.

38. 533 S.W.2d 923 (Tex. 1976).

39. In addition to the transferees, the defendants included the debtor corporation, an alleged corporate officer, and the title insurance company which provided the policy for the transaction. *Id.* at 924-25.

40. *Nobles v. Marcus*, 524 S.W.2d 367 (Tex. Civ. App.—Waco 1975), *aff'd*, 533 S.W.2d 923 (Tex. 1976).

41. 533 S.W.2d at 925.

42. *Id.* at 927.

43. *Id.*; see *Smith v. Carter*, 45 S.W.2d 398, 400 (Tex. Civ. App.—Texarkana 1923, writ *dism'd*).

44. A fraudulent conveyance is a transfer made by a debtor with the intent to hinder, delay, or defraud his creditor by placing the debtor's property beyond the creditor's reach. A fraudulent

II. SECURITIES

The need to comply with the statutory provisions requiring the owner of purloined securities to notify the stock issuer of their disappearance is illustrated by *Exxon Corp. v. Raetzer*.⁴⁵ Plaintiff, prior to October 7, 1969, was the registered owner of 325 shares of stock in the Exxon Corporation. On that date, however, a certificate evidencing his ownership of twenty-five shares was cancelled and the stock was transferred without authorization from plaintiff upon his forged signature. On August 28, 1970, three certificates, each for 100 shares, were cancelled and the stock transferred, again upon plaintiff's forged signature. Plaintiff discovered that the 325 shares were missing from his safety deposit box in September 1969, and he informed his attorney of the disappearance in October 1969. By a letter dated July 22, 1970, plaintiff's attorney informed Exxon that "irregularities in the handling of [plaintiff's] investments have been discovered,"⁴⁶ and requested information of any change in ownership or status of plaintiff's stock. Exxon advised the attorney that plaintiff had 300 shares registered and outstanding in his name but that his certificate representing twenty-five shares had been cancelled.

The trial court found that the letter of July 22, 1970, from plaintiff's attorney was sufficient notice of his loss of the 300 shares and, therefore, Exxon was liable for improper registration.⁴⁷ The court of civil appeals addressed the question of whether plaintiff had notified Exxon of the stock disappearance within a reasonable time. In general, the stock issuer who transfers stock pursuant to an unauthorized signature is subject to liability for improper registration.⁴⁸ But an exception to the general rule provides that the owner of a lost, destroyed, or wrongfully taken security is precluded from asserting against the issuer any claim for improperly registering the transfer by failing to notify the issuer of that fact within a reasonable time after he has notice of it.⁴⁹ The court utilized the statutory definition of notice set out in the Uniform Commercial Code⁵⁰ to hold that the issuer of a missing stock certificate must either have actual knowledge of the stock disappearance or be given actual notice, express or implied, of that fact.⁵¹ The court found that the July 22, 1970, letter to Exxon did not amount to express notice of the missing securities because it contained no literal language signifying that the stock had been lost, destroyed, or stolen.⁵² Similarly, the phrase "ir-

conveyance action is in addition to, and separate from, an action for fraud, requiring specific allegations including one that alleges the transfer to have been a fraud against the right of the creditor. See TEX. BUS. & COMM. CODE ANN. § 24.02 (Vernon 1968).

45. 533 S.W.2d 842 (Tex. Civ. App.—Corpus Christi 1976, writ ref'd n.r.e.).

46. *Id.* at 845. The letter specifically referred to plaintiff's ownership of 325 shares.

47. *Id.* Plaintiff took a nonsuit with respect to his claim for the loss of the 25 shares since they were cancelled and transferred prior to giving Exxon notice. *Id.* at 844.

48. See TEX. BUS. & COMM. CODE ANN. § 8.311 (Vernon 1968).

49. See *id.* § 8.405(a).

50. Notice is defined in section 1.201(25) as follows:

A person has 'notice' of a fact when

(A) he has actual knowledge of it; or

(B) he has received a notice or notification of it; or

(C) from all the facts and circumstances known to him at the time in question he has reason to know that it exists.

Id. § 1.201(25).

51. 533 S.W.2d at 847.

52. *Id.*

regularities in the handling of [plaintiff's] investments" was construed to be limited to matters of business and not to the disappearance of securities. Thus, Exxon had no reasonable or logical basis for inferring that the stock had been misappropriated.⁵³ Finding that sufficient notice had not been given by plaintiff, the court reversed the judgment of the trial court and denied the claim against the company.⁵⁴

A securities dealer located in Texas but doing business solely with purchasers outside of Texas is subject to the provisions of the Texas Securities Act under the holding of *Rio Grande Oil Co v. State*.⁵⁵ Rio Grande Oil was a Texas corporation located in Houston and engaged in the selling of fractional interests in oil and gas leases located in Texas. The company's sales personnel made telephone calls from the corporate headquarters to other states soliciting offers to buy such interests, and information provided by the company was mailed from Texas to prospective out-of-state investors. The oil company maintained its bank accounts in Houston and conducted portions of its business through them.

The State of Texas brought an action against Rio Grande Oil and ten of its employees alleging that they were offering and selling unregistered securities, that the company and its employees were not properly registered with the State Securities Board, and that the defendants had engaged in fraudulent practices in offering and making sales of these interests to investors. The defendants appealed the order of the trial court granting a temporary injunction and appointing a temporary receiver for their assets.

One point of error which the defendants raised on appeal was that the Texas Securities Act does not apply to sales made from Texas to residents of other states. The response of the court of civil appeals was unequivocal: "we think it clear that the Texas Securities Act applies if *any act* in the selling process of securities covered by the Act occurs in Texas."⁵⁶ Article 581-4E of the Act defines the terms "sale," "offer to sell," and "sell" as including every disposition or attempt to dispose of a security for value.⁵⁷ Thus, any one who offers for sale or makes sales of unregistered securities within the State of Texas is in violation of article 581-12.⁵⁸ The decision can be illustrated by two examples. The first occurs when dealers outside of Texas offer to sell or sell securities in Texas by the use of telephone solicitation. The telephone negotiations amount to an offer within the state and are subject to the registration requirements of the Texas Securities Act. A second situation calling for formal registration arises when the individual intending to make a sale engages in solicitation from within Texas and the potential buyers are outside of the state. Once again the "sale," as defined by the statute, occurs within Texas and the seller of the unregistered securities is in violation of the Act.

53. *Id.* at 848.

54. *Id.*

55. 539 S.W.2d 917 (Tex. Civ. App.—Houston [1st Dist.] 1976, writ ref'd n.r.e.).

56. *Id.* at 921-22 (emphasis added).

57. TEX. REV. CIV. STAT. ANN. art. 581-4E (Vernon 1964).

58. Article 581-12 provides that "no person, firm, corporation or dealer shall, directly or through agents or salesmen, offer for sale, sell or make a sale of any securities in this state without first being registered as in this Act provided." *Id.* art. 581-12.