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CORPORATIONS AND PARTNERSHIPS

by

Marc H. Folladori*

UNLIKE last year, few significant Texas legislative and administrative developments affected the practitioner in the corporation and partnership law areas; however, there were many interesting case law developments during the survey period.

I. LEGISLATIVE AND ADMINISTRATIVE DEVELOPMENTS

During 1980 the Revision of Corporation Law Committee of the State Bar's Section on Corporation, Banking and Business Law worked on substantial revisions of the close corporation provisions in the Texas Business Corporation Act.¹ The proposed revision, which will be submitted to the Sixty-seventh Texas Legislature, was drafted in response to a general recognition that the existing close corporation law² is not being sufficiently used.³ Under the proposed law, close corporation status would be obtained simply by electing such status in the articles of incorporation. One goal of the proposed law is to permit shareholders to operate their corporation by means of a shareholders' agreement, in a manner similar to a partnership. In this way, shareholders can divide among themselves, or even designate to some third party, the control of the management and operations of the corporation. The proposed close corporation law would appear in a new Part Twelve of the TBCA.

Effective April 15, 1980, the Texas State Securities Board adopted a new exemptive rule under regulatory authority granted to it pursuant to section 5(T) of the Texas Securities Act.⁴ The new rule exempts certain sales of securities of \$100,000 or more from the registration requirements under section 7 of the Act,⁵ provided all the following conditions are satisfied:

(A) The sale is made, without the use of any public solicitation or advertisements, and to sophisticated, well-informed investors

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1. 18 TEX. ST. B. BULL. SECTION CORP., BANKING & BUS. L. No. 1, Sept. 1980, at 23. The Texas Business Corporation Act is codified at TEX. BUS. CORP. ACT ANN. arts. 1.01-11.01 (Vernon 1980), and is referred to herein as the TBCA.

2. Texas close corporation law is codified at TEX. BUS. CORP. ACT ANN. arts. 2.30-1 to -5 (Vernon 1980).

3. See generally Blunk, *Analyzing Texas Articles of Incorporation: Is the Statutory Close Corporation Format Viable?*, 34 SW. L.J. 941 (1980).

4. TEX. REV. CIV. STAT. ANN. art. 581-5(T) (Vernon Supp. 1980-1981).

5. *Id.* art. 581-7 (Vernon 1964 & Supp. 1980-1981).

(B) The minimum purchase of such security by each investor is \$100,000, and such minimum amount must be paid in cash to the issuer or his agent at or before the closing of the offering.

(C) No securities of the issuer of the same class . . . can be currently registered for sale in Texas, and no application to register securities of the issuer of the same class . . . can be pending.

(D) The entire offering . . . must be sold pursuant to exemptions from the securities registration requirements of the federal securities laws.

(E) Issuers who are not registered securities dealers and who do not sell securities under this subsection by or through registered securities dealers shall file a sworn notice on Form 133.28 . . . not less than 5 (five) business days prior to the making of an offer claimed to be exempt⁶

Persons who purchase under this exemption are not counted as security holders under section 5(I)(a)⁷ or as purchasers under section 5(I)(c)⁸ in determining whether sales to other security holders or purchasers are exempt under section 5(I).⁹ This regulatory exemption should assist issuers raising money in Texas through private placements involving large minimum purchases. Its adoption follows a trend of the Securities and Exchange Commission to exempt from registration and reporting requirements these types of "institutional" offerings.¹⁰

Also, as discussed in the section of this Article on Securities Laws,¹¹ the Texas Securities Board adopted further revisions of their administrative rules and regulations during 1980, some of which should prove to be very helpful to the practitioner.

II. JUDICIAL DEVELOPMENTS

A. Partnerships

Joint Ventures. In recent years many cases have been handed down discussing whether the relationship of the parties constitutes a "joint adventure" or "joint venture," terms that are used interchangeably. In *Great American Mortgage Investors v. Louisville Title Insurance Co.*¹² the court applied the joint adventure doctrine to impute knowledge of deed restrictions by a Texas bank to its co-adventurer in a construction financing arrangement. Great American Mortgage Investors (GAMI), headquartered

6. Tex. Blue Sky Reg. 065.05.00.009(11), 5 Tex. Reg. 1285 (1980), 3 BLUE SKY L. REP. (CCH) ¶ 55,557 (1980). Form 133.28 must disclose the issuer's name, address, and state of incorporation (if applicable); a brief description of the issuer's business plan and the securities to be sold; and whether any person connected with the issuer (including employees) has ever been cited or charged according to nine enumerated actions. *Id.*

7. TEX. REV. CIV. STAT. ANN. art. 581—5(I)(a) (Vernon Supp. 1980-1981).

8. *Id.* art. 581—5(I)(c).

9. Tex. Blue Sky Reg. 065.05.00.009(11)(F), 5 Tex. Reg. 1285 (1980), 3 BLUE SKY L. REP. (CCH) ¶ 55,557 (1980).

10. See 17 C.F.R. §§ 230.146(g)(2)(d), .242 (1980).

11. See notes 136-40 *infra* and accompanying text.

12. 597 S.W.2d 425 (Tex. Civ. App.—Fort Worth 1980, writ ref'd n.r.e.).

in Atlanta, Georgia, entered into a participation agreement with The Wynnewood State Bank in Dallas for the funding of a construction project. Prior to closing, the defendant, the title company, provided the Wynnewood Bank with a mortgagee information letter dated May 4, 1971, containing exceptions to title, including certain deed restrictions. A subsequent information letter dated May 12, 1971, however, did not list the deed restrictions as exceptions, and a title binder issued on May 17, 1971, stated that no deed restrictions were of record. GAMI asserted that it did not learn of the restrictions until adjacent landowners brought suit to secure compliance with the restrictions. The resulting costs of compliance caused the developer to default, and GAMI brought suit against the title company, alleging negligent misrepresentation. Addressing the title company's claim in defense that the loan participation agreement constituted a joint adventure, the court found that: (1) GAMI and the Wynnewood Bank were co-owners of the loan and thus had the requisite "community of interest"; (2) as Wynnewood Bank was to act as if it were the lender and because GAMI possessed the right to approve its actions, there was joint right of control; (3) the participation agreement expressly provided for the sharing of profits and losses.¹³ On these facts, the court concluded that GAMI and Wynnewood Bank were joint adventurers as a matter of law; accordingly, the court held that because Wynnewood Bank's knowledge of the deed restrictions prior to closing of the loan was imputed to GAMI, GAMI could not have justifiably relied on any misrepresentation to the effect that no restrictions existed.¹⁴

In *Gibson v. Northeast National Bank*¹⁵ the court sustained a finding by the trial court that a trade show operator and a travel agency had formed a joint venture for a "floating trade show" and, thus, both were liable as borrowers on a note executed by the trade show operator to the plaintiff bank.¹⁶ Gibson, the only joint venturer to appeal, challenged the jury instruction that "a joint venture between two or more people means an agreement, either express or implied, involving a joint or community interest, to share profits, if any, and losses, if any, and to mutually control or manage the [venture]."¹⁷ The court held that this definition was not in error and that it was unnecessary to make a specific finding of intent to enter a joint venture.¹⁸ Thus, the debt created by one of the defendants for the use of the joint venture became an obligation of the joint venture, and both defendants were liable on the note.¹⁹

Partner Liability. In *Texaco, Inc. v. Wolfe*²⁰ the court dealt with the question of the liability of a partner who had withdrawn from a partnership.

13. *Id.* at 431.

14. *Id.* at 431-32.

15. 602 S.W.2d 337 (Tex. Civ. App.—Fort Worth 1980, writ ref'd n.r.e.).

16. *Id.* at 340.

17. *Id.*

18. *Id.* at 340-41.

19. *Id.* at 341.

20. 601 S.W.2d 737 (Tex. Civ. App.—Houston [1st Dist.] 1980, writ ref'd n.r.e.).

Although several rules in partnership law were reiterated, *Wolfe* primarily stands for the proposition that creditor suits against partners should be pleaded carefully. Texaco sued Charles Wolfe and his brother Nick Wolfe, doing business as Wolfe Construction Company, for amounts due under a credit card. Charles and Nick Wolfe had been partners in Wolfe Construction Company from 1971 until August 1973, when Charles withdrew, and although Charles filed an assumed name certificate stating his withdrawal, he failed to notify Texaco or any other partnership creditors of the dissolution of the partnership. The court cited the general rule that, with respect to a third party doing business with a partnership, each member of the partnership is personally or severally liable for the partnership debts and that such liability continues until the partnership is legally dissolved or until actual notice of withdrawal is given by the withdrawing partner or partners to the partnership creditors.²¹ The court found that a partnership between Charles and Nick Wolfe did exist and that Charles had given no notice to Texaco of his withdrawal therefrom; however, because the pleadings failed to allege the existence of a partnership and Charles's liability as a partner, no judgment could be rendered for Texaco on that basis.²² Texaco had chosen to sue Charles Wolfe personally, and had relied strictly on his original credit card application, without pleading partnership liability in the alternative.²³ The plaintiff's pleading deficiencies were clearly the determinative factors in the outcome of the suit.

Rights of Partners. The case of *Hughes v. Aycock*²⁴ dealt with the alleged forced retirement of a partner from a partnership. In *Hughes* a group of doctors and dentists formed a partnership to construct and maintain a hospital and medical clinic in which they would practice. Because the plaintiff-partner failed to move a substantial portion of his practice to the facilities after they had been constructed, the partnership advised the plaintiff in 1975 that he had been retired pursuant to section 8.9 of the partnership agreement, which provided: "For the purpose of this partnership agreement, the word 'retirement' shall be defined as a situation where: . . . (b) . . . Partners . . . remove their offices from the clinic which is a part of the Houston North Hospital complex *and/or fail to use the Hospital itself for the treatment of their patients.* . . ."²⁵ The partnership tendered an amount that it believed represented the fair market value of the partnership interest owned by the plaintiff, but on June 20, 1975, the plaintiff rejected in writing his alleged retirement and the consideration for his interest. The plaintiff continued to receive his share of the profits and losses until January 1, 1976. In a suit contesting the forced retirement and con-

21. *Id.* at 740-41; see TEX. REV. CIV. STAT. ANN. art. 6132b, § 35 (Vernon 1970).

22. 601 S.W.2d at 741.

23. *Id.* The record disclosed that the original credit cards were destroyed and an application for new cards did not bear Charles's signature. Thus, because the amount owed was under the new cards, Charles, as an individual, was not contractually bound to the obligation.

24. 598 S.W.2d 370 (Tex. Civ. App.—Houston [14th Dist.] 1980, writ ref'd n.r.e.).

25. *Id.* at 372 (emphasis added).

sideration paid therefor, the court of appeals affirmed the trial court decision upholding the forced retirement.²⁶ The court also considered the plaintiff's assertion of error in not being permitted to elect to receive his portion of partnership profits, in lieu of interest, from the date of dissolution until the date of judgment as provided in section 42 of the Texas Uniform Partnership Act.²⁷ Although the court noted that the statute did not dictate *when* the section 42 election was to be made, and that there was no prevailing law on the question, it held that the plaintiff was dilatory in seeking his relief.²⁸ More importantly, the court held that the plaintiff had failed to carry his burden of proof, not only with respect to the profits earned by the partnership after dissolution, but also with respect to those profits that were directly attributable to his capital investment, both of which were necessary for the section 42 election.²⁹ Consequently, plaintiff's election under section 42 was denied.³⁰

In *Dobson v. Dobson*³¹ the court addressed the issue whether a partner's actions constituted a waiver of his rights in the partnership. James M. Dobson, III, and his father, James M. Dobson, Jr., entered into a real estate partnership agreement that provided that the profits and losses were to be divided seventy-five percent to father and twenty-five percent to son. The agreement further provided that either partner could retire from the partnership at the end of any fiscal year, whereupon the remaining partner would have the right to purchase the retiring partner's interest or liquidate the business of the partnership. After the father and son had worked together for a short time, their working relationship deteriorated. On two occasions the son refused to sign notes to cover construction financing for partnership property, and in September 1973 he moved to Dallas while his father continued the partnership business alone. From 1972 to 1976 the partnership filed tax returns showing the son to be the owner of twenty-five percent of the partnership property, and the son in turn claimed his twenty-five percent ownership on his personal tax returns. Additionally, the father, at his son's request, wrote a letter in 1976 to a Dallas loan officer confirming the fact that his son owned twenty-five percent of certain properties of the partnership. In 1977 the son notified his father that he

26. *Id.* at 375. The court noted that because the plaintiff had not moved his practice to the new facilities as he had stated he would, he could not invoke the equitable defense of estoppel to prevent his retirement. *Id.*

27. TEX. REV. CIV. STAT. ANN. art. 6132b, § 42 (Vernon 1970) provides as follows:

When any partner retires . . . and the business is continued . . . without any settlement of accounts as between him . . . and the person or partnership continuing the business, unless otherwise agreed, he . . . as against such persons or partnership may have the value of his interest at the date of dissolution ascertained, and shall receive as an ordinary creditor an amount equal to the value of his interest in the dissolved partnership with interest, or, at his option . . . in lieu of interest, the profits attributable to the use of his right in the property of the dissolved partnership

28. 598 S.W.2d at 376.

29. *Id.* at 376-77.

30. *Id.*

31. 594 S.W.2d 177 (Tex. Civ. App.—Houston [1st Dist.] 1980, writ ref'd n.r.e.).

was retiring from the partnership and offered to sell his twenty-five percent interest. The purchase was never concluded, and the son filed suit for an accounting and for specific enforcement of the partnership agreement's termination provisions. The jury found that the son had waived his rights under the partnership agreement by his failure to pay twenty-five percent of the losses of the partnership and by his refusal to co-sign partnership obligations.³² The court of civil appeals, however, found no provisions for forfeiture or waiver in the partnership agreement and noted that the Texas Uniform Partnership Act³³ did not provide that waiver or forfeiture of rights result from the breach of a partnership agreement.³⁴ The court then cited with approval cases from other Uniform Partnership Act jurisdictions holding that a breach did not result in the forfeiture of a partner's interest.³⁵ Moreover, although no Texas case had decided the issue, the court found support in several Texas joint venture cases,³⁶ and concluded by stating the general rule that "in the absence of explicit provisions in the agreement to the contrary, a breach of the partnership articles will not ordinarily cause a partner to lose his interest in the partnership."³⁷ The court held that under the circumstances, James Dobson, III, did not forfeit or waive the right to his interest.³⁸

B. Corporations

The Corporate Fiction. During the summer of 1980 the Texas Supreme Court decided two cases that should provide some guidelines in the recent multitude of lawsuits that seek to pierce corporate veils. In *Torregrossa v. Szalc*³⁹ the plaintiff Szalc had brought suit against H.E.D. Sales, Inc. and Allan Torregrossa, a shareholder and officer, for breach of implied warranty of title in a used car that Szalc had purchased. The primary question before the Texas Supreme Court was whether sufficient evidence supported the jury finding that H.E.D. Sales, Inc. was the alter ego of Torregrossa, making Torregrossa personally liable for the judgment. The court reaffirmed the general rule in Texas:

Courts will not disregard the corporation fiction and hold individual officers, directors or shareholders liable on the obligations of a corporation except where it appears that the individuals are using the corporate entity as a sham to perpetrate a fraud, to avoid personal liability, or to avoid the effect of a statute, or in a few other excep-

32. *Id.* at 180.

33. The Act is codified at TEX. REV. CIV. STAT. ANN. art. 6132b, §§ 1-46 (Vernon 1970).

34. 594 S.W.2d at 180-81.

35. *Id.* at 181. The court cited, among others, *B.K.K. Co. v. Schultz*, 7 Cal. App. 3d 786, 86 Cal. Rptr. 760 (1970); *Fisher v. Fisher*, 352 Mass. 592, 227 N.E.2d 334 (1967).

36. 594 S.W.2d at 181-82. The court cited *Thompson v. Duncan*, 44 S.W.2d 904 (Tex. Comm'n App. 1932, holding approved); *Lane v. Phillips*, 509 S.W.2d 894 (Tex. Civ. App.—Beaumont 1974, writ ref'd n.r.e.); *Welch v. Brock*, 195 S.W.2d 940 (Tex. Civ. App.—San Antonio 1946, writ ref'd n.r.e.).

37. 594 S.W.2d at 181-82.

38. *Id.* at 182.

39. 603 S.W.2d 803 (Tex. 1980).

tional situations.⁴⁰

As plaintiff, Szalc had the burden of proof on the issue of alter ego, but the court found that he had failed to present evidence of a sham corporate structure.⁴¹ Even though Torregrossa occupied an office on the property and was apparently in a position of authority, nothing indicated that he was the owner of the business. The court noted that when Szalc purchased the car he had made his check payable to H.E.D. Sales, Inc., that the bill of sale was also in the name of the corporation, and that the evidence did not indicate that corporate formalities were not followed by H.E.D. Sales, Inc.⁴² Moreover, the court found that although the corporation was capitalized at the minimum statutory amount, the plaintiff failed to show that this was an unfair device designed to obtain inequitable results.⁴³ The court of appeals had cited *Tigrett v. Pointer*⁴⁴ in support of its holding that insufficient capitalization was a valid ground to pierce the corporate veil.⁴⁵ The supreme court, however, quoted the *Tigrett* opinion, which states that “[i]nadequate capitalization by itself may not be a sufficient ground to pierce the corporate veil,”⁴⁶ and distinguished *Tigrett*, stating that the inadequate capitalization in that case came about through a fraudulent scheme, perpetrated by the major shareholder to acquire virtually all the corporate assets.⁴⁷ Because the record showed no evidence of the type of manipulation found in *Tigrett*, nor evidence indicating that H.E.D. Sales, Inc. was the alter ego of Torregrossa, the court held that Szalc could recover nothing from Torregrossa.⁴⁸

Conversely, in *Sagebrush Sales Co. v. Strauss*⁴⁹ the supreme court reversed a judgment of the court of civil appeals and sustained the trial court’s application of the alter ego theory.⁵⁰ Sagebrush Sales sold building materials to Crawford-Strauss Properties, relying on a detailed financial statement of “Richard C. Strauss, d/b/a Crawford-Strauss Properties.” The financial statement disclosed that Richard Strauss, as an individual, owned the property for which the building materials were purchased, but failed to reveal that Strauss operated through a corporate entity. Though the purchase orders were made on letterhead stating “Crawford-Strauss Properties, Inc.” and were signed by an employee as “Purchasing Agent,” the court stated that, under the circumstances presented, the letterhead was

40. *Id.* at 804.

41. *Id.*

42. *Id.*

43. *Id.* The court noted that the plaintiff failed to show that any unpaid creditors remained and, in fact, that plaintiff presented little evidence concerning the corporate financial structure. *Id.*

44. 580 S.W.2d 375 (Tex. Civ. App.—Dallas 1978, writ ref’d n.r.e.).

45. H.E.D. Sales, Inc. v. Szalc, 596 S.W.2d 299, 301 (Tex. Civ. App.—Houston [14th Dist.]), *rev’d sub nom.* Torregrossa v. Szalc, 603 S.W.2d 803 (Tex. 1980).

46. 603 S.W.2d at 805 (quoting *Tigrett v. Pointer*, 580 S.W.2d 375, 382 (Tex. Civ. App.—Dallas 1978, writ ref’d n.r.e.)).

47. 603 S.W.2d at 805.

48. *Id.*

49. 605 S.W.2d 857 (Tex. 1980).

50. *Id.* at 860.

insufficient to charge Sagebrush, as a matter of law, with knowledge that it was contracting with a corporation.⁵¹ The court, recognizing that each case must be determined according to its own facts, cited the general rule that "personal liability should be imposed on a stockholder only in extraordinary circumstances. . . . One situation wherein personal liability is imposed is where an individual controls and manages the entity in such a manner that it becomes his alter ego."⁵² The jury findings stated that the affairs of the respondent entities, owned and controlled by Richard Strauss, were indistinguishable from Strauss's personal affairs and that Strauss acted in a manner that would lead Sagebrush Sales reasonably to believe that the entities in question had reference to him.⁵³ Accordingly, the supreme court held that the personal judgment against Richard Strauss was proper under the alter ego doctrine.⁵⁴

The State of Texas has assumed the traditional creditor's role in asserting the alter ego doctrine. In *State v. Nevitt*⁵⁵ the state sued to collect delinquent personal property taxes, penalties, and interest that had been assessed against a corporation, from an individual who was a shareholder in the corporation. The court held that the alter ego theory was asserted improperly because the state made no showing of any sham in the transaction claimed.⁵⁶ The state then urged the "trust fund" theory, which states that when a corporation becomes insolvent and ceases to do business, the officers and directors hold the corporate assets in trust for ratable distribution to creditors and a failure to do so imposes personal liability upon the officers and directors.⁵⁷ The court, however, held that the state had failed to show the absence of a ratable distribution or, for that matter, the *value* of any relevant assets; as a result, the court stated that no showing could be made that an application of assets was not ratable as to the state.⁵⁸

Parent Liability for Subsidiary. In addition to the aforementioned alter ego cases, other cases handed down during the survey period involved the liability of a parent corporation for the acts of its subsidiary. Apparently, Texas courts have been lenient in permitting recovery against the parent corporation that uses its subsidiary as a mere instrumentality for conducting the parent's business. In *Jetty, Inc. v. Hall-McGuff Architects*⁵⁹ an architectural firm, Hall-McGuff, sued to recover for its services in connection with the preparation of plans for an office building project for the defendants. The defendants asserted that the trial court had rendered

51. *Id.*

52. *Id.* (citations omitted).

53. *Id.* at 860-61.

54. *Id.* at 861.

55. 595 S.W.2d 140 (Tex. Civ. App.—Dallas 1980, no writ).

56. *Id.* at 143.

57. *Id.*

58. *Id.* The court noted that it could not make a determination of insolvency from the limited information in the record. *Id.* In fact, the court made several references indicating the record was sparse. *Id.* at 143-44.

59. 595 S.W.2d 918 (Tex. Civ. App.—Houston [14th Dist.] 1980, writ ref'd n.r.e.).

judgment wrongfully against the parent, Jetty-Fagg, Inc., because the written contract was between Hall-McGuff and Jetty, Inc., a wholly owned subsidiary. In response to Jetty-Fagg's contention that insufficient evidence existed to show that its subsidiary was a mere conduit for the parent's business, the court noted that Jetty, Inc. had a complete unity of officers and directors with Jetty-Fagg, and that Jetty-Fagg paid for all work done by Hall-McGuff.⁶⁰ Additionally, Jetty, Inc. was a minimally capitalized corporation that had not engaged in any business up to that time, and all its decisions were made by officers of Jetty-Fagg. Concluding that sufficient evidence existed to hold that Jetty, Inc. was a mere conduit of Jetty-Fagg, the court cited the rule that "where management and operations are assimilated to the extent that the subsidiary . . . is simply a name or conduit through which the parent . . . conducts its business, the corporate fiction may be disregarded to prevent fraud or injustice."⁶¹

Likewise, in *Cupples Coiled Pipe, Inc. v. Esco Supply Co.*⁶² plaintiff Esco sued Cupples Coiled Pipe, Inc. (CCP) and Cupples Company Manufacturers (CCM) for damages resulting from the manufacture and sale of defective pipe. CCP was a subsidiary of CCM, and, at the time the defective pipe was sold by CCP in 1974, CCP had interlocking directorates and identical presidents and vice presidents with CCM. At the end of 1975 CCP went out of business and sold its remaining assets for approximately \$330,000, evidenced by a promissory note from the buyer. CCP then assigned the note to CCM as a credit on prior indebtedness, and thereby CCP became, for all practical purposes, a corporate shell. The court first found that, because the action involved strict liability for a defective product under tort law, the loss would be allocated to the parent when its subsidiary became insolvent.⁶³ Secondly, the court stated that the record indicated that CCM exercised such control over the operations of CCP that Esco was placed in a position of disadvantage by inequitable means that could be labeled constructive fraud.⁶⁴ Finally, the court held that the issue was submitted properly to the jury to justify a finding of liability under the law of agency.⁶⁵

Authority of Corporate Officers. The limits of a corporate president's powers were discussed in *Robert Nanney Chevrolet Co. v. Evans & Moses*.⁶⁶ James Austin was a majority shareholder of Robert Nanney Chevrolet Co. and had personally endorsed certain of the corporation's debt documents. When the corporation encountered financial problems, Austin feared for his personal funds and commenced to liquidate the corporation. The corporate president, Robert Nanney, hired the defendant law firm to thwart

60. *Id.* at 921.

61. *Id.* (quoting *Gentry v. Credit Plan Corp.*, 528 S.W.2d 571, 573 (Tex. 1975)).

62. 591 S.W.2d 615 (Tex. Civ. App.—El Paso 1979, writ ref'd n.r.e.).

63. *Id.* at 618.

64. *Id.*

65. *Id.* at 619.

66. 601 S.W.2d 411 (Tex. Civ. App.—Beaumont 1980, no writ).

the liquidation and signed a corporate check for the \$2,000 fee. The bank, however, returned the check for lack of a countersignature, and the law firm sued the corporation for its fee. The court held against the law firm, stating that Robert Nanney had no direct authority from the board of directors to sign the check without a countersignature.⁶⁷ Moreover, according to the court, the hiring of counsel in an attempt to thwart the will of a majority of the board of directors and stockholders was not a routine matter arising in the ordinary course of business and, therefore, was not within the inherent power of a corporate president.⁶⁸

In *Crisp v. Southwest Bancshares Leasing Co.*⁶⁹ Southwest Bancshares claimed that it had been defrauded in certain equipment leasing transactions and sought relief from a group of defendants including Crisp, president of Crisp Equipment. According to Crisp, the president of Southwest Bancshares at the time of the transactions was aware of the fraudulent transactions and was complicitous in the schemes. Crisp therefore argued the doctrine that when the agent (Southwest Bancshares' president) acts for both himself and his principal, the agent's knowledge is imputed to the principal, who will not be allowed to achieve an advantage secured by the fraud of the agent. The court, however, held that the doctrine was for the protection of innocent third parties and did not protect those who collude with the agent to defraud the principal.⁷⁰ Finding that the principal, Southwest, was not chargeable with the fraudulent acts of its agent, the court affirmed the judgment against the defendants.⁷¹

Derivative Suits. In *Zauber v. Murray Savings Association*⁷² the plaintiff Ray Zauber brought a derivative action on behalf of Murray Savings Association, seeking an accounting for and recovery of assets allegedly converted from Murray Savings to the use and benefit of certain affiliates and insiders. Both at the time of the alleged wrongful transaction and at the time the action was filed, Murray Financial Corporation (the parent of Murray Savings), Zauber, and another individual held the total outstanding stock of Murray Savings Association. After Zauber filed suit, Murray Financial purchased the other individual's shares. Shortly thereafter, Murray Savings held a shareholders' meeting that Zauber failed to attend, during which the shareholders authorized a reverse stock split. Zauber's stock ownership was reduced to less than one share as a result of the reverse split, and he was given cash for his fractional share. Zauber, however, refused to accept the tendered cash payment. At trial the defendants claimed that Zauber had not complied with the requirements of the deriv-

67. *Id.* at 413.

68. *Id.*

69. 586 S.W.2d 610 (Tex. Civ. App.—Amarillo 1979, writ ref'd n.r.e.).

70. *Id.* at 615. The court cited a Texas case and a federal case in support of this principle. See *Southern Farm Bureau Cas. Ins. Co. v. Allen*, 388 F.2d 126, 131 (5th Cir. 1967); *Centennial Mut. Life Ass'n v. Parham*, 80 Tex. 518, 527, 16 S.W. 316, 319 (1891).

71. 586 S.W.2d at 615-16.

72. 591 S.W.2d 932 (Tex. Civ. App.—Dallas 1979), writ ref'd n.r.e. per curiam, 601 S.W.2d 940 (Tex. 1980).

ative action statute, article 5.14(B)(2)(b) of the TBCA,⁷³ and that because he had ceased to be a shareholder during the pendency of the litigation, he could not maintain a derivative suit. Furthermore, the defendants contended that the plaintiff was bound by the decision of the board of directors of Murray Savings not to pursue the action as the decision was made in the exercise of sound business judgment.

Addressing the defendants' assertions, the court first noted that, pursuant to article 5.14(B), a plaintiff should plead that he has made efforts to have the board bring suit for the corporation.⁷⁴ The record indicated that the plaintiff had made no such demand on the Murray Savings board. The court stated, however, that such demand need not be made if it can be shown that the demand would be futile. The court emphasized that in the latter case the principal issue was whether the directors could not be expected to pursue the action diligently because of personal interest in the controversy or because of control over the board by the alleged wrongdoers.⁷⁵ The court found that because the defendants' control over the board, if any, was a genuine issue of fact, so was the plaintiff's standing to sue.⁷⁶

Secondly, the court addressed the argument that, in order to comply with article 5.14(B)(1), the plaintiff must be a shareholder at the time of the wrongful transaction. The defendants claimed that the federal rule governing derivative suits,⁷⁷ which is similar to the Texas rule, had been construed to require that the plaintiff maintain shareholder status throughout the suit.⁷⁸ The court, suggesting that the reverse stock split may have been an involuntary disposal of the plaintiff's shares, ordered that on remand any finding that the plaintiff had failed to maintain shareholder status depended upon whether the disposition of his stock was voluntary or involuntary.⁷⁹ In the event the trial court should determine that the disposition was involuntary, the court stated that the plaintiff would be allowed to proceed with the suit unless the reverse split was intended to accomplish a

73. TEX. BUS. CORP. ACT ANN. art. 5.14(B) (Vernon 1980) provides:

Prerequisites. A derivative suit may be brought in this State only if:

(1) The plaintiff was a record or beneficial owner of shares . . . at the time of the transaction of which he complains . . . and

(2) The initial pleading in the suit states:

(a) The ownership required by Subsection (1), and

(b) With particularity, the efforts of the plaintiff to have suit brought for the corporation by the board of directors, or the reasons for not making any such efforts.

74. 591 S.W.2d at 936. The court of civil appeals corrected the trial court's misapplication of TEX. R. CIV. P. 42, dealing with class actions, to derivative suits, and held that the latter is to be governed instead by art. 5.14(B) of the Texas Business Corporation Act set forth in note 73 *supra*. 591 S.W.2d at 935-36.

75. 591 S.W.2d at 937.

76. *Id.*

77. FED. R. CIV. P. 23.1.

78. 591 S.W.2d at 937. *See generally* Blackmon v. Hansen, 140 Tex. 536, 540, 169 S.W.2d 962, 964 (1943) (when a Texas statute was taken literally from a federal statute, it was presumed that the Texas Legislature adopted the statute as construed by federal courts).

79. 591 S.W.2d at 938.

valid business purpose.⁸⁰

Finally, the court held that the defendants' contention that the plaintiff should be bound by the decision of the board of directors not to pursue the action was not relevant to the plaintiff's right to maintain the suit.⁸¹ Rather, the court returned to the statutory allegation of futility and the fact question of the defendants' control over the board.⁸² According to the court, if the facts on remand indicated that a demand was required, the plaintiff would not be allowed to proceed with the action.⁸³ If, however, the facts indicated that demand was not required, the court held that the plaintiff could maintain the action despite the decision by the board of directors.⁸⁴

As in *Zauber*, the Dallas court of civil appeals again addressed the issue of a shareholder's standing to sue derivatively,⁸⁵ but did so only to the extent necessary to support an action for a temporary injunction. In *Sonics International, Inc. v. Dorchester Enterprises, Inc.*⁸⁶ the named parties were principal shareholders of Coastal Plains, Inc. Dorchester brought the derivative suit, challenging a proposed contract between the corporation and its controlling shareholder, without making a demand on the Coastal Plains board of directors as required by article 5.14(B). Dorchester claimed that such efforts would have been futile because a majority of the board was allied with the defendant Sonics. Sonics contended that the board had delegated the decision whether the suit should be prosecuted to an independent special committee, whose decision not to sue was made in the exercise of sound business judgment and, consequently, was binding on both Coastal Plains and Dorchester. The court found that the action of the board and its special committee did not defeat Dorchester's standing to sue for the purpose of securing a temporary injunction against payment under the contract.⁸⁷ The court held that the trial court would have the discretion at a later stage of the litigation to determine on the merits what effect the committee's decision had on Dorchester's right to relief.⁸⁸

Effect of Forfeiture of Corporate Charter. In *Regal Construction Co. v. Hansel*⁸⁹ Regal brought suit against Hansel seeking recovery of the balance due on an oral contract for remodeling the Hansel residence. Following institution of the suit, the secretary of state's office in Austin forfeited the

80. *Id.*

81. *Id.*

82. *Id.* at 938-39. The statute is set out in part at note 73 *supra*.

83. 591 S.W.2d at 939.

84. *Id.*

85. For other cases involving the power of the board of directors to dismiss a derivative action under the business judgment rule, see *Burks v. Lasker*, 441 U.S. 471 (1979); *Abbey v. Control Data Corp.*, [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,949 (8th Cir. 1979); *Lewis v. Anderson*, [1979-1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,153 (9th Cir. 1979).

86. 593 S.W.2d 390 (Tex. Civ. App.—Dallas 1980, no writ).

87. *Id.* at 392.

88. *Id.*

89. 596 S.W.2d 150 (Tex. Civ. App.—Houston [1st Dist.] 1979, no writ).

corporate charter of Regal for nonpayment of franchise taxes. Because the forfeiture resulted in a denial of the plaintiff's right to prosecute as a corporation, James Allen, the sole shareholder of Regal, filed an amended petition seeking recovery as sole shareholder under the cause of action originally pleaded by Regal. The court recognized that the effect of a charter forfeiture was to prohibit the corporation from doing business in Texas and to deny it the right to sue in a Texas court.⁹⁰ Nonetheless, the court stated:

The legal title to the assets remains in the corporation, but the beneficial title to the assets of the corporation is in the stockholders. This being true, and since the right to sue has been denied to the corporation by the forfeiture, the stockholders, as beneficial owners of the assets of the corporation, may prosecute or defend such actions in the courts as may be necessary to protect their property rights.⁹¹

The court held that Allen was the beneficial owner of the assets of Regal and was entitled to intervene in the suit filed by Regal for the purpose of prosecuting the suit as its sole shareholder.⁹²

On rehearing, the Hansels contended that the legislature had provided a statutory method for securing reinstatement of the forfeited corporate charter and that in the absence of compliance with this procedure the corporation may not sue. The court, however, did not accept the conclusion that reviving the corporate charter was the only means to proceed with the litigation, and held that Regal's sole shareholder was not precluded from suing in his own right.⁹³ Accordingly, rehearing was denied.⁹⁴

*Roylex, Inc. v. Langson Bros. Construction Co.*⁹⁵ dealt with the personal liability of corporate officers and shareholders after forfeiture of the corporate charter, as well as related issues under the alter ego theory.⁹⁶ In an action to recover on an alleged contract debt, the plaintiff asserted that because the corporate charter of the defendant construction company had been forfeited, the shareholders or the officers were personally liable on the corporation's contractual obligations to the plaintiff. The court rebutted the argument, noting that the contract at issue had been entered into three years before the date of forfeiture and that the work performed under it likewise had been completed long before the charter was for-

90. *Id.* at 153.

91. *Id.*

92. *Id.*

93. *Id.* at 156-57; see *Humble Oil & Ref. Co. v. Blankenburg*, 149 Tex. 498, 235 S.W.2d 891 (1951) (when corporate charter was forfeited, shareholders as beneficial owners of corporate assets could prosecute or defend in court to protect their property rights); *Pratt-Hewitt Oil Corp. v. Hewitt*, 122 Tex. 38, 52 S.W.2d 64 (1932) (when corporation was unable to sue to remedy wrongs from directors' fraud, shareholder may sue on behalf of himself and other shareholders for corporation's benefit). *But see* TEX. BUS. CORP. ACT ANN. art. 8.18, comment (Vernon 1980) (last para.) (art. 8.18 negates the *Pratt-Hewitt* decision that allowed shareholders to sue for a foreign corporation that had not yet obtained a certificate of authority from the state).

94. 596 S.W.2d at 157.

95. 585 S.W.2d 768 (Tex. Civ. App.—Houston [1st Dist.] 1979, writ ref'd n.r.e.).

96. See notes 39-58 *supra* and accompanying text.

feited.⁹⁷ Thus, under the circumstances, the court held that the officers and shareholders were not personally liable.⁹⁸ Regarding the plaintiff's contention that the corporation was merely the alter ego of the individual defendants, the court held that the evidence did not merit consideration of the alter ego issue.⁹⁹

Jurisdiction. A relatively large number of cases handed down during the survey period concerned questions of venue or jurisdiction over corporations, but the cases primarily involved the application of established legal principles. Most cases dealt with the applicability of the Texas long-arm statute¹⁰⁰ to foreign corporations allegedly doing business in Texas, and the courts generally applied the two-part test, (i) whether the nonresident defendant is subject to process under the terms of the long-arm statute, and (ii) whether the exercise of personal jurisdiction is consistent with the requirements of due process of law.¹⁰¹

*Wright Waterproofing Co. v. Applied Polymers of America*¹⁰² was typical of the jurisdiction cases. In a suit for breach of warranty on a defective waterproofing compound, the court reviewed the question of jurisdiction over a New Jersey corporation with an agent allegedly representing the corporation in Texas. The court found that Applied Polymers, the defendant, was indeed doing business in Texas within the ambit of the long-arm statute.¹⁰³ The court examined three factors to determine whether constitutional due process requirements were met in order to subject the nonresident defendant to Texas jurisdiction: (1) the foreign corporation purposely must do some act or consummate some transaction in Texas; (2) the cause of action must arise from or be connected with such act or transaction; and (3) the assumption of jurisdiction by Texas courts must not offend traditional notions of fair play and substantial justice.¹⁰⁴ In this respect, the court noted that consideration must be given to "the quality, nature, and extent of the activity in [Texas], the relative convenience of the parties, the benefits and protection of the laws of [Texas] afforded the respective parties, and the basic equities of the situation."¹⁰⁵ First, the court found that the acts of the defendant's president in coming to Texas and meeting with a prospective client constituted purposeful acts within the State of

97. 585 S.W.2d at 773.

98. *Id.*

99. *Id.* at 772.

100. TEX. REV. CIV. STAT. ANN. art. 2031b (Vernon 1964 & Supp. 1980-1981).

101. *See, e.g.*, *Jamesbury Corp. v. Kitamura Valve Mfg. Co.*, 484 F. Supp. 533 (S.D. Tex. 1980) (Japanese corporation was not "doing business" in Texas and had insufficient minimum contacts for jurisdiction); *Gutierrez v. Raymond Int'l, Inc.*, 484 F. Supp. 241 (S.D. Tex. 1979) (in application of Texas long-arm statute, defendant nonresident corporation was not amenable to jurisdiction though it had extensive land holdings in Texas and certain of its subsidiaries resided in Texas).

102. 602 S.W.2d 67 (Tex. Civ. App.—Dallas), *writ ref'd n.r.e. per curiam*, 608 S.W.2d 164 (Tex. 1980).

103. *Id.* at 70.

104. *Id.* at 71.

105. *Id.* (quoting *O'Brien v. Lanpar Co.*, 399 S.W.2d 340, 342 (Tex. 1966); *Tyce Constr. Co. v. Dulien Steel Prods., Inc.*, 62 Wash. 2d 106, 381 P.2d 245, 251 (1963)).

Texas.¹⁰⁶ Secondly, because these acts led to the purchase of the defendant's product by the plaintiff, the court held that the cause of action arose from the purposeful acts.¹⁰⁷ Finally, the court ruled that requiring the defendant to defend in Texas would not offend traditional notions of fair play and substantial justice.¹⁰⁸ Thus, all requirements of due process were met.

Consideration for the Issuance of Shares. *Emco, Inc. v. Healy*¹⁰⁹ dealt with the issue of valid consideration for a corporation's issuance of its stock. John Healy bought stock in Emco, a small company that manufactured outdoor lighting fixtures, with financing arranged by First Trust and Savings Bank of Davenport, Iowa. Healy agreed to purchase 3,334 shares of Emco common stock and gave a note payable to Emco for \$50,000, pledging the 3,334 shares as security for the note. Emco immediately assigned the note and security agreement with recourse to the bank and received the proceeds in return. Healy defaulted on the note, and the bank called upon Emco for performance. Emco paid the note, took a reassignment from the bank, and filed suit against Healy. At trial Emco argued that because the corporation actually received money in consideration for the issuance of its stock, it received full value for Healy's note when the note was transferred to the Davenport bank and, therefore, did not violate the Texas constitutional and statutory provisions regarding the issuance of corporate stock.¹¹⁰ The court disagreed, however, stating that because Emco's assignment of the note to the bank was with full recourse it amounted to no more than a loan advance by the bank on the collateral of the note.¹¹¹ The court stated the following rule: "Where a note is transferred by the corporation to a third party and the corporation still remains secondarily or contingently liable on the note, the stock is not considered paid for."¹¹² The

106. 602 S.W.2d at 71.

107. *Id.*

108. *Id.*

109. 602 S.W.2d 309 (Tex. Civ. App.—Texarkana 1980, no writ).

110. TEX. CONST. art. XII, § 6 provides: "No corporation shall issue stock or bonds except for money paid, labor done or property actually received, and all fictitious increase of stock or indebtedness shall be void." TEX. BUS. CORP. ACT ANN. art. 2.16 (Vernon 1980) provides:

A. The consideration paid for the issuance of shares shall consist of money paid, labor done, or property actually received. Shares may not be issued until the full amount of consideration, fixed as provided by law, has been paid. When such consideration shall have been paid to the corporation or to a corporation of which all of the outstanding shares of each class are owned by the corporation, the shares shall be deemed to have been issued and the subscriber or shareholder entitled to receive such issue shall be a shareholder with respect to such shares, and the shares shall be considered fully paid and non-assessable.

B. Neither promissory notes nor the promise of future services shall constitute payment or part payment for shares of a corporation.

111. 602 S.W.2d at 312. The court also rejected Emco's contention that because the note was secured by the stock itself, it constituted "property actually received" in accordance with constitutional and statutory requirements. *Id.* at 313.

112. *Id.* at 312 (citation omitted).

court therefore affirmed the trial court's holding that the note in the hands of Emco was unenforceable.¹¹³

Foreign Corporations. Article 8.18 of the TBCA¹¹⁴ prohibits foreign corporations that are transacting or have transacted business in the state without a certificate of authority from maintaining any action, suit, or proceeding in any court of the state. In *Squyres Construction Co. v. Chemical Bank*¹¹⁵ the court held that plaintiff Chemical Bank, a foreign corporation, could bring suit in Texas for a deficiency due after repossession and sale of equipment under a lease agreement without violating article 8.18.¹¹⁶ The court stated at the outset that the burden was on the defendant to plead and prove facts indicating that the plaintiff was a foreign corporation that could not maintain a suit, particularly when such facts did not affirmatively appear in the plaintiff's petition.¹¹⁷ Furthermore, the court found that the lease document stated that the agreement was "deemed to have been made in New York," that the plaintiff had no duty to perform any act in Texas concerning the leased equipment, and that rental payments were payable to the bank in New York.¹¹⁸ Accordingly, the court found that the appellants failed to prove that the plaintiff transacted business in Texas so as to be barred from maintaining the suit.¹¹⁹

Sale of Assets. In *Padre Sands, Inc. v. Cawood*¹²⁰ the issue was whether a listing agreement for the sale of a corporation's property was void due to the selling corporation's failure to acquire the consent of two-thirds of the shareholders as required by article 5.10(A)(3) of the TBCA.¹²¹ Jack Cawood, a real estate broker, sued Padre Sands for a commission pursuant to a listing agreement covering tracts owned by Padre Sands that then constituted its sole assets. The listing agreement was executed by Padre Sands' president and secretary-treasurer, who subsequently received authorization from the board of directors to enter into the listing agreement. After a prospective purchaser procured by Cawood signed a contract of sale, Padre Sands failed to execute the contract and did not pay Cawood his commission under the agreement. Padre Sands argued that because holders of

113. *Id.* at 313.

114. TEX. BUS. CORP. ACT ANN. art. 8.18 (Vernon 1980).

115. 596 S.W.2d 283 (Tex. Civ. App.—Houston [1st Dist.] 1980, no writ).

116. *Id.* at 284. The bank obtained rights in the lease agreement by assignment from the lessor, Advanced Leasing Services.

117. *Id.*; see *Ero Indus., Inc. v. Be-In Buttons Co.*, 473 S.W.2d 667, 679 (Tex. Civ. App.—Houston [1st Dist.] 1971, no writ).

118. 596 S.W.2d at 284.

119. *Id.* The court also noted that the plaintiff could maintain the action according to TEX. BUS. CORP. ACT ANN. art. 8.01 (Vernon 1980), which provides that creating evidences of debt is not considered to be transacting business in the state. 596 S.W.2d at 284.

120. 595 S.W.2d 896 (Tex. Civ. App.—Corpus Christi 1980, writ ref'd n.r.e.).

121. TEX. BUS. CORP. ACT ANN. art. 5.10(A)(3) (Vernon 1980) requires two-thirds consent of the holders of the outstanding shares of the corporation for any "sale, lease, exchange, or other disposition . . . of all, or substantially all, the property and assets . . . of a corporation."

the requisite two-thirds of the shares of the corporation had refused to consummate the proposed sale, the agreement was illegal under article 5.10 and, therefore, no commission was due. The court, focusing on the issue of whether the listing agreement was within the purview of article 5.10, noted that such an agreement did not obligate the owner to convey title or any interest in the land but was merely a method of soliciting a ready, willing, and able purchaser.¹²² Consequently, the court held that the agreement was not a sale, lease, exchange, or other dispositional contract under article 5.10, and that because the agreement was not void, plaintiff was entitled to recover his brokerage commission.¹²³

Indemnification. In the case of *Texas Society v. Fort Bend Chapter*¹²⁴ the Fort Bend Chapter of the National Society, Daughters of the American Revolution sued the Texas Society, Daughters of the American Revolution, Inc. and its officers for misuse of the nonprofit corporation's funds. The officers were being sued in another action for fraud and conspiracy in dealing with the Society's assets, and the primary issue in the case at bar was whether the Texas Society was justified in selling its assets to pay the attorneys' fees of its officers prior to a court determination that the officers were innocent. The court stated that pursuant to article 2.22 of the Texas Non-Profit Corporation Act¹²⁵ the corporation could indemnify the officers for actual legal expenses and costs incurred in their defense action only after a final determination that they were not guilty of negligence or misconduct.¹²⁶ Thus, the court upheld the trial court's temporary injunction to preserve the corporation's assets.¹²⁷ On motion for rehearing, the court emphasized that the right to indemnification does not arise from the common law, but rather is purely statutory, and the court stated that no statutory provision authorizes the advancement of expenses in connection with litigation against corporate officers.¹²⁸ Alternately, the court reasoned that a corporate officer breaches his fiduciary duty to the corporation when he diverts its assets to his personal use and accordingly he is liable for such misuse.¹²⁹ The motion for rehearing was denied.¹³⁰

Shareholder Agreements. In *Whitaker v. Vastine*¹³¹ the individual parties to the suit owned all the stock in Bag 'N' Baggage, Inc. in the following

122. 595 S.W.2d at 899.

123. *Id.* The court suggested that the officers of the corporation could have provided in the listing agreement that the payment of the sales commission was subject to the approval of the sale by two-thirds of the shareholders. *Id.*

124. 590 S.W.2d 156 (Tex. Civ. App.—Texarkana 1979, writ ref'd n.r.e.).

125. TEX. REV. CIV. STAT. ANN. art. 1396—2.22 (Vernon 1980).

126. 590 S.W.2d at 159.

127. *Id.*

128. *Id.* at 164. Actually, the statute permissively authorizes indemnification without stating when it may be granted. The statute does make an exception from indemnification for those found guilty of misconduct or negligence, thus necessitating by implication a final adjudication to determine whether the individuals fall within the exception.

129. *Id.*

130. *Id.* at 166.

131. 601 S.W.2d 398 (Tex. Civ. App.—Dallas 1980, writ ref'd n.r.e.).

percentages: appellant Andrew Whitaker, 51%; appellee William Vastine, 25%; and appellee Charles Whitaker, 24%. In January 1978 the parties executed an agreement providing that any future acquisition of Bag 'N' Baggage stock by them would be made in the following percentages: Andrew Whitaker, 49%; Vastine, 25.5%; and Charles Whitaker, 25.5%. Later that year, stock certificates were issued to Vastine and Charles Whitaker, supposedly in accordance with the agreement, representing shares of stock sufficient to bring the ownership percentages of the three shareholders in line with the agreement. This issuance triggered a conflict among the parties concerning interpretation of the agreement's stock ownership terms. Andrew Whitaker argued that the percentages applied only to stock acquired subsequent to the agreement, while Vastine and Charles Whitaker maintained that the contractual percentages were intended to establish the current ratios in which the individuals would own shares in the corporation and consequently, the issuance of stock certificates was required to achieve the new ownership percentages. Andrew Whitaker filed suit to have the stock certificates issued to Charles Whitaker and Vastine cancelled or reissued in the proportions outlined in the 1978 agreement, but the trial court dismissed the action. On appeal Andrew Whitaker claimed that issuance of the certificates without authorization from the board of directors violated the corporation's bylaws as well as Texas law.¹³² The court agreed with appellant's contention and stated the law: "When the shareholders of a corporation vest power in a board of directors, issuance of stock can only be authorized at a valid meeting of the board, regularly called."¹³³ The court, noting that no other theory had been presented to support the issuance of the certificates, concluded that because such issuance was not authorized, the certificates were void and the shares should be cancelled.¹³⁴

III. SECURITIES REGULATION

In addition to the \$100,000-purchase exemptive regulation promulgated by the State Securities Board during 1980,¹³⁵ the board promulgated rules late in the survey period that ease regulatory burdens. For example, the board adopted a rule permitting directors, officers, agents, and employees of an issuer to answer offeree questions under Securities and Exchange Commission Rule 146¹³⁶ without requiring them to register as dealers, agents, or salespersons under the Texas Securities Act.¹³⁷ More impor-

132. Appellant also argued that the stock was issued before consideration was fully paid in violation of TEX. CONST. art. XII, § 6 and TEX. REV. CIV. STAT. ANN. art. 1353 (Vernon 1980), which prohibit the issuance of stock except for money paid or property received. The court, however, failed to address this argument.

133. 601 S.W.2d at 403 (citations omitted).

134. *Id.*

135. See notes 4-10 *supra* and accompanying text.

136. 17 C.F.R. § 230.146 (1980).

137. See Tex. Blue Sky Reg. 065.08.00.001(f), 5 Tex. Reg. 3000 (1980), 3 BLUE SKY L. REP. (CCH) ¶ 55,591 (1980). The Texas Securities Act is codified at TEX. REV. CIV. STAT. ANN. arts. 581—1 to —39 (Vernon 1964 & Supp. 1980-1981).

tantly, the board adopted a "blue chip" exemption from registration for sales of securities of issuers whose performance and financial stability meet specified criteria drawn from the registration provisions of the Texas Securities Act.¹³⁸ Also, the original rule on advertising was repealed and replaced by new "Guidelines for Regulation of Offers,"¹³⁹ and the disclosure standards for tender offers were updated.¹⁴⁰

In the courts, litigation once again ensued regarding the definition of a security. In *Wilson v. Lee*¹⁴¹ the appellants had purchased from Claude R. McClennahan, Inc. interests in a joint venture that was to hold certain tracts of land for appreciation and resale. The property acquired by the joint venture was located in a remote rural area where any immediate use was limited to farming and pasturage. According to the record, the appellants never contemplated the generation of any profit in the joint venture through development or operation of the property. The corporation had been designated manager of the joint venture, but its only managerial activities consisted of protecting, preserving, and maintaining the property in a condition suitable for resale. The participant's ownership agreement provided that sixty percent of the interest owners could change the nominee title holder of the property to an entity of their choice at any time, that certain actions required unanimous consent of all owners, and that the right to direct joint venture operations was vested in the owners of sixty percent in interest. The appellants brought an action under the Texas Securities Act that relied heavily on the allegation that they had been sold a "security" as defined under the Act.¹⁴² Consequently, the only issue before the court of appeals was whether the joint venture in land constituted a "security."

Focusing on the manner in which the venture earned income, the court looked to the United States Supreme Court for guidance in determining the existence of a security: "The test is whether the scheme involves an investment of money in a common enterprise with profits to come *solely* from the efforts of others."¹⁴³ The court also approved a broader state-

138. See Texas Blue Sky Reg. 065.20.00.003, 5 Tex. Reg. 4146 (1980), 3 BLUE SKY L. REP. (CCH) ¶ 55,713 (1980). This exemptive provision, effective Oct. 29, 1980, exempts sales of securities by the issuer if, briefly stated: (i) the securities are senior to or on a parity with a class of the issuer's securities registered under § 12 of the Securities Exchange Act of 1934, 15 U.S.C. § 78f (1976); (ii) the issuer has not had any material defaults in the last seven years on payment of indebtedness or long-term lease rentals; (iii) the issuer's net income for four of the last five years was at least one million dollars each year, and net income for the preceding year was at least one-and-one-half times the corporation's expected interest expense; (iv) the securities to be issued, if stock, have certain voting rights; (v) the securities, if common stock, are held by at least 1,200 persons with at least 750,000 shares outstanding and have an aggregate market value of \$3,750,000 or more. *Id.*

139. Tex. Blue Sky Reg. 065.17.00.100-.700, 5 Tex. Reg. 3046 (1980), 3 BLUE SKY L. REP. (CCH) ¶¶ 55,694A-G (1980).

140. See Tex. Blue Sky Reg. 065.15.00.500, 5 Tex. Reg. 3045 (1980), 3 BLUE SKY L. REP. ¶ 55,678 (1980).

141. 601 S.W.2d 483 (Tex. Civ. App.—Dallas 1980, writ filed).

142. For a definition of "security" under the Act, see TEX. REV. CIV. STAT. ANN. art. 581—4(A) (Vernon 1964).

143. 601 S.W.2d at 485 (emphasis by court) (quoting SEC v. Howey, 328 U.S. 293, 301

ment by the Supreme Court that a security involves "a reasonable expectation of profits to be derived from the *entrepreneurial or managerial efforts of others*."¹⁴⁴ Applying this lenient test, the court found that no management efforts were directed toward making a profit, and that the owners expected market inflation alone to be the determinant of any increase in value.¹⁴⁵ Furthermore, the court found no merit in the contention that the property caretaking efforts of the investors and others were a determinative factor in finding a security.¹⁴⁶ Finally, the court cited *McConathy v. Dal Mac Commercial Real Estate, Inc.*¹⁴⁷ as applicable to the fact situation at hand. The *McConathy* court held that a joint venture to acquire and hold land for appreciation, without relying on the developmental or managerial skills of another, was more akin to a partnership and was not within the definition of a security.¹⁴⁸ Consequently, the court of appeals affirmed the trial court and held that an investment with others in raw land with the expectation of appreciation solely by market inflation was not the purchase of a "security."¹⁴⁹

Similarly, in *Adickes v. Andreoli*¹⁵⁰ the court dealt with the issue of whether an interest in a real estate limited partnership represented a security. Andreoli purchased an interest in a limited partnership for the purpose of land speculation, as in *Wilson*, and brought an action for rescission under the Texas Securities Act and common law principles of fraud. The court again analyzed the *McConathy* decision and relied on the proposition that state securities laws are not involved when several persons join and furnish part of the purchase price of real property. The court found that the interest in question was not an "instrument representing or secured by an interest in the capital, property, assets, profits or earnings of a company,"¹⁵¹ and, in accordance with the result in *Wilson*, stated: "We find no evidence that it was the expectation of the parties that the success of the venture would depend on those 'essential managerial efforts . . . which effect the failure or success of the enterprise.'"¹⁵²

(1946)). The quoted language is the Court's definition of an "investment contract" as that term is used under the federal securities acts.

144. 601 S.W.2d at 485 (emphasis by court) (quoting *United Hous. Foundation, Inc. v. Forman*, 421 U.S. 837, 852 (1975)).

145. 601 S.W.2d at 486.

146. *Id.* Appellants had argued that a security existed in this case just as it did in those cases involving pyramid selling schemes. The court, however, could not accept the analogy because the "efforts" in the case at bar were not significant enough to generate profits.

147. 545 S.W.2d 871 (Tex. Civ. App.—Texarkana 1976, no writ).

148. *Id.* at 875. Numerous authorities contained in the *McConathy* opinion support the rule that the mere holding of property in anticipation of appreciation is insufficient to find a security. *Id.* The courts apparently require a more substantive showing of "efforts."

149. 601 S.W.2d at 487.

150. 600 S.W.2d 939 (Tex. Civ. App.—Houston [1st Dist.] 1980, writ filed).

151. 600 S.W.2d at 945 (citations omitted).

152. *Id.* (citations omitted).