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January 1983

## Corporations and Partnerships

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### Recommended Citation

David Simon Sokolow, *Corporations and Partnerships*, 37 Sw L.J. 165 (1983)  
<https://scholar.smu.edu/smulr/vol37/iss1/8>

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# CORPORATIONS AND PARTNERSHIPS\*

by

David Simon Sokolow\*\*

A NUMBER of judicial decisions during the survey period affected the law of partnerships and corporations in Texas. The most significant of these recent developments occurred in the area of securities regulation. These decisions and developments are canvassed below.

## I. PARTNERSHIPS

*Formation.* In one of the most unusual cases to arise during the survey year, the primary issue was whether two women who had been involved in a long-term lesbian relationship had formed a partnership. In *Small v. Harper*<sup>1</sup> Jo Ann Small brought suit against her former lover, Aldean Harper, to recover a share of the property that the parties had acquired during their twelve- to fifteen-year relationship. Included in the property was a single family dwelling, title to which was in Harper's name alone. Small contended that she and Harper had formed a partnership by orally agreeing to commingle their assets, to invest in real estate and other property, and to share any profits. In the alternative, she alleged that she and Harper had entered into a series of joint ventures.

Harper moved for summary judgment. The only evidence she offered in support of her motion were portions of Small's sworn deposition in which Small repeatedly characterized her relationship with Harper in terms of marriage<sup>2</sup> and admitted that the women had no agreement concerning the contribution of assets to the claimed partnership for profit.<sup>3</sup> Solely on the basis of the deposition testimony the trial court granted summary judgment in favor of Harper.

On appeal the court considered significant Small's testimony that the

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The author wishes to express his appreciation to several of his colleagues who offered valuable advice and counsel during the preparation of this Article: Barbara Bader Aldave, Robert W. Hamilton, Leon Lebowitz, Scott McCown, John J. Sampson, and Russell J. Weintraub. The author is also indebted to Eileen Rapke, The University of Texas School of Law, class of 1983, for her tireless and diligent research and editorial assistance.

1. 638 S.W.2d 24 (Tex. Ct. App.—Houston [1st Dist.] 1982, no writ).

2. In her testimony, Small characterized her relationship with Harper as a "marriage-type relationship" and as a "marriage" and depicted the parties as doing "all of the things that a married couple would do." *Id.* at 26-27 (emphasis deleted).

3. *Id.*

parties had agreed to invest together.<sup>4</sup> The court also found that the deposition testimony as a whole raised a number of factual issues concerning the couple's business affairs, including whether the women had combined funds to invest in stocks with the expectation of jointly sharing the proceeds, whether they had pooled their assets to purchase other property, and whether they had commingled their incomes in order to achieve monetary gains.<sup>5</sup> Furthermore, the court found no public policy that would preclude Small, as a lesbian, from recovering against Harper based on a partnership or on a series of joint ventures.<sup>6</sup> The court therefore held that summary judgment was improper and remanded for a new trial.<sup>7</sup>

Although Small will now have the opportunity to prove that she and Harper did form a partnership, her deposition testimony strongly suggests that the women were not carrying on as co-owners a business for profit.<sup>8</sup> Insofar as Small is seeking a share in what is presumably the couple's residence and insofar as her claim is predicated on a marriage-type relationship, Small appears to be demanding an equitable settlement of the couple's joint property under the guise of a partnership claim.<sup>9</sup>

*Fiduciary Duty.* The scope of the fiduciary duty of a joint venturer to his co-venturers was at issue in *Sanchez v. Matthews*.<sup>10</sup> Andrew Sanchez, Jr., James O. Matthews, and a third party formed a joint venture to sell a parcel of land. The parties deeded legal title to the land to Sanchez who was to actively manage the property. When the joint venturers were unable to sell the land at a profit, they decided to sell it at a price that would return to them only their initial cost and expenses. Sanchez obtained from a buyer an earnest money contract on the property, and the three co-venturers divided \$15,000 as the total net profit on their investment. Shortly afterwards, without informing his co-venturers, Sanchez arranged to acquire from the buyer the same percentage interest in the land that he held in the joint venture. The repurchase was concluded soon after the property was conveyed to the buyer. When the buyer resold the property two years later, Sanchez received more than \$150,000 as net profit from his interest in the land.

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4. *Id.* at 27.

5. *Id.*

6. *Id.* at 28. The court gleaned the state's public policy on this subject primarily from *Hayworth v. Williams*, 102 Tex. 308, 116 S.W. 43 (1909), in which the Texas Supreme Court held that the question of whether a woman who had married a bigamist had rights in real property was a question of fact to be submitted to the jury. *Id.* at 314, 116 S.W. at 46. The court also noted a case recognizing an express trust in favor of a woman who had lived with a man without the benefit of marriage. *See Cluck v. Sheets*, 141 Tex. 219, 171 S.W.2d 860 (1943).

7. 638 S.W.2d at 30.

8. TEX. REV. CIV. STAT. ANN. art. 6132b, § 6 (Vernon 1970) defines a partnership as "an association of two or more persons to carry on as co-owners a business for profit."

9. The California Supreme Court in *Marvin v. Marvin*, 18 Cal. 3d 660, 557 P.2d 106, 134 Cal. Rptr. 815 (1976), recognized that a partnership was distinct from other types of arrangements that a pair-bonded couple could enter into. *Id.* at 674 n.10, 557 P.2d at 116 n.10, 134 Cal. Rptr. at 825 n.10.

10. 636 S.W.2d 455 (Tex. Ct. App.—San Antonio 1982, writ ref'd n.r.e.).

Matthews brought suit against Sanchez alleging a breach of fiduciary duty arising from the joint venture. Finding that Sanchez had breached his fiduciary duty to Matthews, the trial court imposed a constructive trust on the profits Sanchez had derived from the resale of the joint venture property. On appeal Sanchez contended that the joint venture had terminated before he repurchased an interest in the land, and that he therefore owed no fiduciary duty to Matthews. The court of appeals examined four Texas Supreme Court decisions<sup>11</sup> and concluded that the supreme court has "limited the scope of a joint venture for the purpose of imposing a constructive trust."<sup>12</sup> Nevertheless, the court found that Sanchez's fiduciary duty to Matthews did not terminate when Sanchez sold the property on behalf of the joint venture.<sup>13</sup> Because the original agreement embraced the interest Sanchez received in this subsequent deal, the court held that a constructive trust was properly imposed on his profits from the resale.<sup>14</sup>

Although the court reached a sensible result in this case, the court misconstrued Texas Supreme Court precedent. The court in *Sanchez* cited *Huffington v. Upchurch*<sup>15</sup> as direct support for the proposition that the supreme court has limited the fiduciary responsibilities arising from a joint venture; yet, the court in *Huffington* imposed a constructive trust, emphasizing the extraordinary fiduciary duty that a managing partner owes to his co-partners.<sup>16</sup> Neither *Huffington* nor any of the other decisions the court cited in *Sanchez* suggests that the supreme court has adopted a generally restrictive view of joint ventures for the purpose of imposing a constructive trust.<sup>17</sup>

*Rights of Partners.* Two cases during the survey period concerned a partner's alleged conversion of partnership assets. In *Pignataro v. Russo*<sup>18</sup> the

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11. These decisions are *Rankin v. Naftalis*, 557 S.W.2d 940 (Tex. 1977); *Huffington v. Upchurch*, 532 S.W.2d 576 (Tex. 1976); *Consolidated Gas & Equip. Co. v. Thompson*, 405 S.W.2d 333 (Tex. 1966); and *Omohundro v. Matthews*, 161 Tex. 367, 341 S.W.2d 401 (1960).

12. 636 S.W.2d at 459.

13. *Id.*

14. *Id.*

15. 532 S.W.2d 576 (Tex. 1976).

16. *Id.* at 579 (citing *Smith v. Bolin*, 153 Tex. 486, 492, 271 S.W.2d 93, 96 (1954), which in turn cited *Meinhard v. Salmon*, 249 N.Y. 458, 164 N.E. 545 (1928)). Although joint venturers are not technically partners, *Sanchez*, 636 S.W.2d at 459 (citing G. & G. BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 488 (rev. 2d ed. 1978)), cases involving partnership principles are routinely cited in cases involving joint ventures. See, e.g., *Hackney v. Johnson*, 601 S.W.2d 523, 526 (Tex. Civ. App.—El Paso 1980, writ ref'd. n.r.e.) (citing *Colonial Refrigerated Transp., Inc. v. Mitchell*, 403 F.2d 541, 546 (5th Cir. 1968); J. CRANE & A. BROMBERG, LAW OF PARTNERSHIPS § 35, at 189 (1968)).

17. The Texas Supreme Court in *Rankin v. Naftalis*, 557 S.W.2d 940 (Tex. 1977), did indicate that it would not impose a constructive trust on profits derived by an individual venturer from an independent enterprise that the original joint venture agreement did not embrace. *Id.* at 944. The reasoning of *Rankin*, however, has no application when a venturer sells for his individual profit the very property that is the subject of the original joint venture, see *Omohundro v. Matthews*, 161 Tex. 367, 341 S.W.2d 401 (Tex. 1960), *Sanchez*, 636 S.W.2d at 459, or where the joint venture agreement is drafted to extend to other enterprises. See *Huffington*, 532 S.W.2d at 578 (agreement indicated that scope of venture was to extend to all mineral interests acquired by any of the parties).

18. 633 S.W.2d 571 (Tex. Ct. App.—Houston [14th Dist.] 1982, writ ref'd n.r.e.).

court held that a partner who used partnership assets to continue the business after dissolution was not liable in conversion to a retiring partner who had elected to receive the value of his interest at the time of dissolution under section 42 of the Texas Uniform Partnership Act.<sup>19</sup> The court reasoned that section 42 "envisions the continuation of business operations employing partnership assets and compensates the partner who leaves . . . . Because of that compensation and the purpose of § 42, the use of partnership assets after dissolution cannot be viewed as conversion."<sup>20</sup>

Under other circumstances, however, a partner may be held liable in conversion. In *Shannon v. Monasco*<sup>21</sup> the court found that the parties' division of the partnership assets among themselves terminated the partnership and the defendants' right to exercise control over those assets.<sup>22</sup> The court consequently found the defendants liable in conversion for seizing former partnership property that had been distributed to the plaintiffs.<sup>23</sup>

## II. CORPORATIONS

*Piercing the Corporate Veil.* *Hickman v. Rawls*<sup>24</sup> exemplifies the reluctance of Texas courts to pierce the corporate veil and impose alter ego liability on corporate shareholders and directors for contractual obligations of the corporation. In *Hickman* two architects sought to recover from corporate shareholders for plans the architects had prepared pursuant to a contract with the corporation. In light of evidence that the corporation had been unable to pay for the architectural services when the parties executed the contract, that the corporation had forfeited its corporate charter for failure to pay franchise taxes, and that it had not observed the requisite corporate formalities,<sup>25</sup> the trial court held the shareholders liable for the corporate debt. The court of appeals reversed, refusing to pierce the corporate veil in the absence of "extraordinary circumstances where the corporate entity is used to perpetrate a fraud against the public."<sup>26</sup> The court of appeals found that the corporation had been organized for a legitimate purpose, but had failed for economic reasons beyond the control of the individual shareholders.<sup>27</sup> Moreover, since the plaintiffs had had the opportunity to investigate the corporation's financial status before entering into the contract, the court concluded they could not complain when the corporation

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19. *Id.* at 573; see TEX. REV. CIV. STAT. ANN. art. 6132b, § 42 (Vernon 1970).

20. 633 S.W.2d at 573 (citing *Ogle v. Craig*, 456 S.W.2d 778, 780 (Tex. Civ. App.—Amarillo 1970), *modified*, 464 S.W.2d 95 (Tex. 1971)).

21. 632 S.W.2d 946 (Tex. Ct. App.—Waco 1982, writ ref'd n.r.e.).

22. *Id.* at 948.

23. *Id.* at 949.

24. 638 S.W.2d 100 (Tex. Ct. App.—Dallas 1982, no writ).

25. The corporation had held only one board of directors' meeting and one shareholders' meeting during its existence; it had failed to open a checking account and make loans, although both actions had been authorized by the bylaws and by corporate resolution; stock certificates had never been filled out; and no financial records had been maintained.

26. *Id.* at 102; see also *Torregrossa v. Szalc*, 603 S.W.2d 803 (Tex. 1980) (court will not pierce corporate veil absent evidence that corporate form is being used as a sham).

27. 630 S.W.2d at 102.

was unable to meet its obligations.<sup>28</sup>

A plaintiff's ability to recover based on alter ego liability may depend on his pleadings. In *Federson v. Dillon*<sup>29</sup> the plaintiff sued the officers of a corporation for tortious interference with a contract that the plaintiff had made with the corporation. The court found little, if any, evidence that either of the corporate officers had participated in his individual capacity in any of the alleged acts of interference; thus, only the alter ego theory of liability could have supported a judgment against the individual defendants.<sup>30</sup> The court held, however, that the plaintiff's failure to plead the alter ego theory in a timely fashion precluded him from recovering against either of the individual defendants on that ground.<sup>31</sup>

One who has chosen to do business in the corporate form may occasionally benefit from arguing that the corporate entity should be disregarded, but courts are generally unsympathetic to that view.<sup>32</sup> In *McDonald v. Bennett*<sup>33</sup> the Fifth Circuit dealt with the issues of whether, and to what extent, an individual could recover for damages suffered by the corporation of which he was the sole shareholder. By misrepresenting the financial condition of Englewood Industries, two of its three shareholders induced Charles McDonald to invest in Englewood. McDonald was the sole shareholder of Sealy International Technical Corporation (SITCO). To bolster Englewood's financial position McDonald arranged for SITCO to obtain a loan, the proceeds of which SITCO used to purchase Englewood's assets, to pay off Englewood's creditors, and to purchase Englewood stock for McDonald. Despite these and other efforts by McDonald to rescue Englewood, Englewood was forced into bankruptcy, and McDonald ultimately lost his investment.

After a jury trial the district court awarded McDonald his out-of-pocket losses as well as all sums SITCO had expended as a consequence of the fraud. On appeal to the Fifth Circuit the defendant contended that all of the money spent and lost by SITCO properly belonged to SITCO,<sup>34</sup> and not to McDonald. McDonald rejoined that he had properly recovered for SITCO's losses under the rule of *Heinrichs v. Evins Personnel Consultants, Inc.*,<sup>35</sup> in which a defrauded individual was permitted to recover sums his closely held corporation paid to purchase a franchise on his behalf.<sup>36</sup>

The Fifth Circuit did not fully agree with either party. It found McDon-

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28. *Id.*

29. 623 S.W.2d 696 (Tex. Civ. App.—Houston [1st Dist.] 1981, no writ).

30. *Id.* at 697.

31. *Id.*

32. See, e.g., *Delta Pipe Fabricators, Inc. v. Bullock*, 638 S.W.2d 652 (Tex. Ct. App.—Austin 1982, no writ) (parent corporation seeking to avoid imposition of excise and sales taxes on its wholly owned subsidiary).

33. 674 F.2d 1080 (5th Cir. 1982).

34. The defendant argued in the alternative that the damages belonged to Energy Building Systems Corporation (EBSCO), a corporation into which MacDonal merged SITCO between the time he had purchased an interest in Englewood and the time of trial. McDonald owned 70% of the stock of EBSCO.

35. 486 S.W.2d 935 (Tex. 1972).

36. *Id.* at 936.

ald's reliance on *Heinrichs* misplaced: in *Heinrichs* only the check drawn on the corporation linked the corporation with the purchased franchise, whereas in this case SITCO was clearly involved with Englewood.<sup>37</sup> Reiterating the Texas position that a shareholder cannot recover as an individual on a cause of action vested in the corporation, even if he owns all or substantially all of the corporation's capital stock,<sup>38</sup> the court concluded that only SITCO was entitled to recover the corporation's losses.<sup>39</sup> The court, however, did permit McDonald to recover the money that SITCO had paid to purchase the Englewood stock for him under an exception that allows a shareholder to recover expenditures made by a corporation on the shareholder's behalf.<sup>40</sup> Thus, consistent with *Heinrichs*, the court allowed McDonald to recover the value SITCO paid for McDonald's benefit but refused to let him personally reclaim the sums expended by SITCO on its own behalf.<sup>41</sup>

Finally, the alter ego doctrine was raised as a defense to criminal liability in *Weaver v. State*.<sup>42</sup> Weaver represented to persons who bought debentures from him that he would use the proceeds of the sales to commence the operations of Can of Worms, Inc., a business venture formed to market cans of worms as novelty items. The purchasers of the debentures sued Weaver for violating the securities laws, alleging that Weaver intended to use the proceeds to pay off creditors of Worm Enterprises, a company from which Can of Worms, Inc. was contractually obligated to buy its worms, and of which Weaver was an investor-member. Weaver contended as a defense that Can of Worms, Inc. and Worm Enterprises were alter egos, presumably to prove that he had not diverted assets from Can of Worms, Inc. The court found Weaver's use of the alter ego doctrine unavailing, asserting that the doctrine, being remedial in nature, is a means of piercing the corporate veil to hold individuals personally liable in certain actions and is not available as a defense.<sup>43</sup>

*Parent Liability for Subsidiary.* Courts are often more willing to allow plaintiff's to recovery on the alter ego theory against a parent corporation that uses a subsidiary to insulate itself from liability than against an individual who is using a closely held corporation for a similar purpose. *Texas Industries, Inc. v. Lucas*<sup>44</sup> illustrates this point. Randall Lucas had been

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37. 674 F.2d at 1085. As evidence of SITCO's involvement with Englewood, the court cited the sale-leaseback arrangement between the two corporations pertaining to Englewood's assets; SITCO's pledging Englewood's assets as collateral in connection with two separate loans; and a loan proposal that repeatedly referred to a new corporation formed to manufacture polyurethane panels as "EBSCO/Englewood." *Id.*

38. *Id.* (quoting *Stinnett v. Paramount-Famous Lasky Corp.*, 37 S.W.2d 145, 149 (Tex. Comm'n App. 1931, holding approved)).

39. 674 F.2d at 1085.

40. *Id.* at 1086 (citing *Cullum v. General Motors Acceptance Corp.*, 115 S.W.2d 1196, 1201 (Tex. Civ. App.—Amarillo 1938, no writ)).

41. 674 F.2d at 1087.

42. 638 S.W.2d 511 (Tex. Ct. App.—Houston [1st Dist.] 1982, no writ).

43. *Id.* at 513 (citing *Tigrett v. Pointer*, 580 S.W.2d 375 (Tex. Civ. App.—Dallas 1978, writ ref'd n.r.e.)).

44. 634 S.W.2d 748 (Tex. Ct. App.—Houston [14th Dist.] 1982, writ granted).

injured by a beam manufactured by TXI Structural Products, Inc. (Structural). Lucas brought suit against Texas Industries, Inc. (TII), Structural's parent corporation, to recover for his injuries, and after a jury trial, was awarded damages against TII. On appeal the question facing the court was whether TII was so closely identified with Structural that it would be equitable to hold TII liable for Structural's actions. The court looked for guidance to a noted law review article<sup>45</sup> that had been favorably cited by the Texas Supreme Court<sup>46</sup> and abstracted from it fourteen considerations relevant to the determination of whether a parent corporation is liable for the acts of its subsidiary. Because these considerations are instructive, they are set out here in full:

- (1) stock ownership; (2) degree to which the subsidiary is financed by the parent; (3) the method of such financing; (4) the extent to which there is a common directorate; (5) the extent to which there are common officers and employees; (6) the extent to which separate meetings of stockholders and directors are held; (7) the extent to which both have common departments of business; (8) the degree to which contracts between the two are favorable to one rather than the other; (9) the extent to which separate books and accounts are kept; (10) the extent to which an officer or director of one is permitted to determine the policies of the other; (11) the extent to which an employee, officer, or director of the parent is casually [sic] connected with the tort or contract on which the suit is brought; (12) the type of business of each; (13) the extent to which the trade or public generally regards the two units as one business unit; (14) whom the contract claimant regards as the promisor.<sup>47</sup>

Applying these considerations to the facts, the court found sufficient evidence to uphold the jury's finding that TII was Structural's alter ego.<sup>48</sup> TII owned all of Structural's stock and financed all of Structural's operating capital. The two companies had many of the same officers, filed consolidated tax returns and used the same logo. Furthermore, Structural's business derived exclusively from contracts entered into by TII. In this regard the court found it particularly important that the contract to manufacture the beam that had caused the plaintiff's injuries had been addressed to TII but signed by an employee of Structural under the name "Texas Industries, Inc."<sup>49</sup> In light of this evidence the court affirmed the judgment against TII.<sup>50</sup>

The court, in passing, offered some advice to parent corporations wishing to avoid alter ego liability. The parent should form a separate, ade-

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45. See Douglas & Shanks, *Insulation from Liability Through Subsidiary Corporations*, 39 YALE L.J. 193 (1929).

46. See *Gentry v. Credit Plan Corp.*, 528 S.W.2d 571 (Tex. 1975); see also 19 R. HAMILTON, BUSINESS ORGANIZATIONS § 234, at 236-37 (Texas Practice 1973) (setting forth standards to follow to maintain the distinction between parent and subsidiary).

47. 634 S.W.2d at 752-53.

48. *Id.* at 753.

49. *Id.* The court also found that TII dictated Structural's safety policies and that TII had no business other than doing business through its subsidiaries. *Id.*

50. *Id.*



quately capitalized financial unit for the subsidiary and keep separate the day-to-day business and the management structures of the two companies.<sup>51</sup> In addition, the parent should ensure that persons doing business with either company are aware that the companies are distinct entities.<sup>52</sup> Presumably a parent corporation that follows the court's advice will fare better than TII did in *Lucas*.

*Usury.* Usury laws impose a ceiling on the interest rate that a lender may charge an individual borrower.<sup>53</sup> The extent to which a lender can require an individual to incorporate in order to avoid this ceiling<sup>54</sup> was the subject of *Shook v. Republic National Bank*.<sup>55</sup> On July 30, 1974, John Shook executed a personal note payable to Republic National Bank in the amount of \$698,500 to renew his existing indebtedness to Republic. Republic had previously informed Shook that, after the July 30th note came due, it would be unable to extend him further credit at the interest rate it could lawfully charge him as an individual.<sup>56</sup> When the note came due on August 30, 1974, Shook executed a \$698,500 note payable to Republic on behalf of J.L.S., Inc.,<sup>57</sup> a Texas corporation Shook had formed on July 22, 1974. The corporate note bore interest at a rate in excess of the maximum rate Republic could lawfully charge an individual. Shook subsequently sought recovery of twice the interest he had paid on the corporation's note,<sup>58</sup> alleging that J.L.S., Inc. was formed in order to evade Texas usury laws.

In assessing Shook's claim the court noted that a lender could require a borrower to incorporate even though the purpose of incorporation was to allow the lender to charge the higher corporate rate of interest so long as the corporation was not solely used to disguise a usurious loan to an individual.<sup>59</sup> Looking to the substance of the transaction, the court concluded that the J.L.S., Inc. loan was usurious.<sup>60</sup> The court found critically significant the fact that J.L.S., Inc. had no business purpose for the loan; it obtained the loan only to refinance Shook's existing indebtedness to

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51. *Id.* at 752-53 (citing Douglas & Shanks, *supra* note 45).

52. *Id.* 753 (citing Douglas & Shanks, *supra* note 45).

53. Unless otherwise provided by statute, *see infra* note 56, the maximum rate of interest that may be charged to an individual is 10% per annum. TEX. REV. CIV. STAT. ANN. art. 5069—1.02 (Vernon 1971).

54. A corporation may agree to pay up to 1½% per month on loans in excess of \$5,000, TEX. REV. CIV. STAT. ANN. art. 1302—2.09 (Vernon 1980), or an alternative rate of interest that does not exceed the rates authorized in art. 5069—1.04 (Vernon Supp. 1982-1983). *Id.* art. 1302—2.09A (Vernon 1980 & Supp. 1982-1983).

55. 627 S.W.2d 741 (Tex. Ct. App.—Tyler 1981, writ granted).

56. As a national bank, Republic at that time could have lawfully charged Shook a maximum interest rate equal to the higher of the rate allowable under Texas law or one percent in excess of the discount rate on 90-day commercial paper in effect at the Dallas Federal Reserve Bank. *Id.* at 745 n.1 (citing 12 U.S.C.A. § 85 (West Supp. 1980)).

57. Shook personally guaranteed the corporation's note.

58. *See* Interest—Consumer Credit and Consumer Protection Act, 1967 Tex. Gen. Laws, ch. 274, § 2, at 610, *amended by* Act of May 24, 1979, 1979 Tex. Gen. Laws, ch. 281, § 1, at 604-05.

59. 627 S.W.2d at 746-47.

60. *Id.* at 747-48.

Republic.<sup>61</sup> The court also found that J.L.S., Inc. was a shell corporation with no business activity, no income, no shareholders' or directors' meetings, and no employees.<sup>62</sup> The court accordingly held that Shook was entitled to recover the usurious interest.<sup>63</sup> This case has generated considerable interest within the Texas banking community,<sup>64</sup> and the Texas Supreme Court has granted a writ of error on the case.<sup>65</sup>

*Shareholders' Agreements.* In *Tashnek v. Tashnek*<sup>66</sup> members of the same family owned three corporations that were primarily engaged in real estate investments. Friction among the shareholders prompted them to enter into a written agreement to consolidate the corporations' assets in one corporation and to liquidate the assets of the successor corporation. The agreement provided in part that:

As of the close of business on February 2, 1976, each Shareholders [sic] agree [sic], warrants, represents, and does hereby authorize and instruct the proper officers of R-L-D Properties, Inc. to distribute as a final distribution in liquidation all remaining assets in the hands of the Corporation, including any cash, real and personal property as follows . . . .<sup>67</sup>

When the distribution of the corporate assets was delayed from February 2, 1976, until November 1976, the minority shareholders sued the controlling shareholders, who were also directors of the corporation, for breach of the agreement. Acknowledging that the agreement might not bind a director of a corporation in his capacity as a director, the court concluded that this fact would not affect the defendants' liability as shareholders for breaching the obligations they had assumed pursuant to the terms of the shareholder agreement.<sup>68</sup> The court also found that the nonbreaching shareholders were not required to bring a derivative suit because the failure to distribute the assets in a timely manner constituted a wrong against them as shareholders and individuals, as well as a wrong against the corporation.<sup>69</sup> The court, therefore, affirmed the award of compensatory damages to the plaintiffs.<sup>70</sup>

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61. *Id.* at 747.

62. *Id.* at 748.

63. *Id.* at 752. The court also rejected the bank's argument that Shook waived or should be estopped from asserting his usury claim because he was a lawyer. The court followed the general rule that waiver and estoppel are not defenses to a usury cause of action. *Id.* at 751.

64. See TEX. BANK LAW., June 1982, at 1; Crump, *Shook v. Republic Bank: Another View*, TEX. BANK LAW., Aug. 1982, at 3.

65. 25 Tex. Sup. Ct. J. 449 (July 24, 1982). After this Article went to press, the Texas Supreme Court reversed the lower court, holding that the loan involved was not usurious. 26 Tex. Sup. Ct. J. 365, 368 (May 4, 1983).

66. 630 S.W.2d 653 (Tex. Ct. App.—Houston [1st Dist.] 1981, no writ).

67. *Id.* at 655.

68. *Id.* at 656.

69. *Id.* (citing *Stinnett v. Paramount-Famous Lasky Corp.*, 37 S.W.2d 145 (Tex. Comm'n App. 1931, holding approved)).

70. 630 S.W.2d at 656.

*De Facto Merger.* Despite the Texas Legislature's recent attempt to bar product liability claims against one corporation that has acquired the assets of another absent the acquiring corporation's express assumption of such liability,<sup>71</sup> the de facto merger doctrine may not yet be moribund with respect to claims arising before the effective date of article 5.10B.<sup>72</sup> In *Castilla v. Trinity Industries, Inc.*<sup>73</sup> Jose Luis Castilla brought suit against Custom Tool and Machine Company and Trinity Industries, Inc. for injuries he had suffered while performing maintenance work on a rotary kiln manufactured and sold by Custom. Trinity acquired Custom's assets after the kiln was sold but before the accident occurred. Trinity did not expressly assume liability for product liability claims that might be brought against Custom. Observing that the facts of this case arose before the effective date of article 5.10B,<sup>74</sup> the court suggested that Castilla might have succeeded in proving a cause of action against Trinity<sup>75</sup> had he shown that a de facto merger had resulted from Trinity's acquisition of Custom's assets.<sup>76</sup> The court, however, found no evidence that Trinity was the successor corporation to Custom.<sup>77</sup> As the concurring justice pointed out, no officer or director of Custom had become an officer or director of Trinity, and the product line in question had been discontinued.<sup>78</sup>

*Corporate Agents.* Although it is elementary that one who signs a document on behalf of a corporation should use the proper form of corporate signature, this principle is often ignored. In *Dalton v. George B. Hatley Co.*<sup>79</sup> the plaintiff corporation sought reimbursement for payments it had made on two notes signed by the corporation's president as an accommo-

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71. TEX. BUS. CORP. ACT ANN. art. 5.10B (Vernon 1980).

72. The effective date of the statute was May 17, 1979. *Id.*

73. 626 S.W.2d 798 (Tex. Ct. App.—San Antonio 1981, writ dismissed).

74. *Id.* at 802.

75. The precise question before the court was whether venue would lie against Trinity under subsection 23 of the Texas venue statute. TEX. REV. CIV. STAT. ANN. art. 1995(23) (Vernon 1964). To maintain venue under subsection 23, the plaintiff must plead and prove his cause of action by competent evidence at the venue hearing. 626 S.W.2d at 799 (citing *Santleben v. Taylor-Evans Seed Co.*, 585 S.W.2d 784, 786 (Tex. Civ. App.—San Antonio 1979, no writ); *Pesek v. Murrel's Welding Works, Inc.*, 558 S.W.2d 39, 44 (Tex. Civ. App.—San Antonio 1977, writ dismissed w.o.j.)).

76. 626 S.W.2d at 800 (citing *Western Resources Life Ins. Co. v. Gerhardt*, 553 S.W.2d 783 (Tex. Civ. App.—Austin 1977, writ refused n.r.e.)).

77. 626 S.W.2d at 800.

78. *Id.* at 801 (Baskin, J., concurring) (distinguishing *Western Resources Life Ins. Co. v. Gerhardt*, 553 S.W.2d 783 (Tex. Civ. App.—Austin 1977, writ refused n.r.e.)).

Castilla also argued that Trinity should nevertheless be held liable to him as a matter of policy for injuries resulting from a defective product manufactured by Custom, even though Trinity was not involved in its manufacture, sale, or design, because Trinity, as a purchasing corporation, was "better able to spread the loss of injury." *Id.* at 801 (Baskin, J., concurring). The majority did not address this issue, but the concurrence soundly rejected it, noting that Texas public policy, as embodied in art. 5.10B, was precisely the opposite of the policy urged by Castilla. *Id.* at 802 (Baskin, J., concurring). Given the legislature's swift response to the decision imposing liability in *Gerhardt*, the concurrence is surely correct. See TEX. BUS. CORP. ACT ANN. art. 5.10 comment (Vernon 1980).

79. 634 S.W.2d 374 (Tex. Ct. App.—Austin 1982, no writ).

dation to the defendant.<sup>80</sup> The president had signed the notes "George B. Hatley." The court found no evidence on the face of the notes that the president had signed the notes in his capacity as a corporate officer or agent;<sup>81</sup> he had designated neither his title nor the name of the corporation. Moreover, the court was unpersuaded that repayment of the delinquent notes with corporate funds was evidence that the president had signed the notes in his representative capacity.<sup>82</sup> The court therefore concluded that the corporation could not recover as an accommodation maker on the notes.<sup>83</sup>

As a general rule the business affairs of a corporation are under the management of the board of directors,<sup>84</sup> and corporate shareholders have no authority to bind the corporation in its dealings with third parties.<sup>85</sup> In *Rapp v. Felsenthal*,<sup>86</sup> however, the court held that a management contract executed by the sole shareholder of the corporation in his own name was binding on the corporation even though the execution of the contract was not authorized at a formal meeting of the directors.<sup>87</sup> The court reasoned that a corporation may be bound by a contract in which all of its shareholders join because the shareholders are the equitable owners of the corporation's assets.<sup>88</sup> Although the court recognized that the shareholder in this case was also the corporation's president and one of its directors at the time the contract was made,<sup>89</sup> the rationale articulated by the court would operate to bind the corporation even when the shareholders are not corporate officers or directors.

Although the actions of a board of directors ordinarily bind the corporation only if the board has been properly constituted, a court may disregard irregularities in the election of a board member in order to prevent the corporation from benefitting unjustly at the expense of a third party. In *Austin Lake Estates Recreation Club, Inc. v. Maberry*<sup>90</sup> a corporation sued to cancel two promissory notes it had given to the defendant. The corporation contended that the board of directors that had authorized the execu-

80. An accommodation maker is "one who signs the instrument in any capacity for the purpose of lending his name to another party on it." TEX. BUS. & COM. CODE ANN. § 3.415(a) (Tex. UCC) (Vernon 1968).

81. 634 S.W.2d at 378.

82. *Id.* (citing TEX. BUS. & COM. CODE ANN. § 3.403(b) (Tex. UCC) (Vernon 1968)).

83. 634 S.W.2d at 379. The court ruled, however, that the corporation could recover from Dalton in its capacity as the transferee of the notes. *Id.* (citing TEX. BUS. & COM. CODE ANN. §§ 3.201(a), 3.603(b) (Tex. UCC) (Vernon 1968)).

84. TEX. BUS. CORP. ACT ANN. art. 2.31(A) (Vernon 1980).

85. *Itasca Roller Mill & Elevator Co. v. Wooten*, 246 S.W. 678 (Tex. Civ. App.—Dallas 1922, no writ).

86. 628 S.W.2d 258 (Tex. Ct. App.—Fort Worth 1982, writ ref'd n.r.e.).

87. *Id.* at 260.

88. *Id.* (citing *Forrest v. Guardian Loan & Trustee Co.*, 230 S.W.2d 273 (Tex. Civ. App.—El Paso 1950, no writ); *Norris v. Cox*, 131 S.W.2d 1028 (Tex. Civ. App.—El Paso 1939, writ dismissed judgment cor.); *Boston & Tex. Corp. v. Guarantee Life Ins. Co.*, 233 S.W.1022 (Tex. Civ.—Galveston 1921, writ ref'd); *United States & Mexican Trust Co. v. Delaware W. Constr. Co.*, 112 S.W. 447 (Tex. Civ. App. 1908, no writ)).

89. 628 S.W.2d at 260.

90. 638 S.W.2d 649 (Tex. Ct. App.—Austin 1982, writ ref'd n.r.e.).

tion of the notes was not properly constituted because one of the directors had failed to meet the residence requirement imposed on directors by the corporation's bylaws. The court concluded, however, that the director could bind the corporation in this case because she qualified as a de facto director.<sup>91</sup> The court defined a de facto director as one who has been elected to the office, but who has no legal title to it because of some informality or irregularity in the election.<sup>92</sup> The court recognized that a de facto director can bind the corporation only with respect to third parties who are unaware of the de facto director's true status.<sup>93</sup> Because the director in this case had been elected to the board and because the court found that the defendant "could have believed"<sup>94</sup> the director was qualified, the court upheld the validity of the promissory notes.<sup>95</sup> In situations where the de facto director doctrine is not available to remedy the defect in the composition of a corporation's board of directors, a corporation may, nevertheless, be bound by an earlier unauthorized act of its board of directors if a properly constituted board later ratifies the act.<sup>96</sup>

*Scope of Long-Arm Jurisdiction.* A subject of continuing controversy in the state and federal courts has been the reach of article 2031b, the Texas long-arm statute.<sup>97</sup> Simply stated, the issue is whether jurisdiction over nonresident defendants under article 2031b is limited to suits arising out of the defendant's activities in Texas, or extends as far as due process will allow.<sup>98</sup> Last year, in *Prejean v. Sonatrach, Inc.*,<sup>99</sup> the Fifth Circuit concluded that article 2031b applies only to suits arising out of the defendant's contacts with Texas<sup>100</sup> and requires a causal relationship or nexus between the defendant's Texas contacts and the plaintiff's cause of action.<sup>101</sup> In *Hall v. Helicopteros Nacionales de Colombia, S.A.*,<sup>102</sup> however, a divided Texas Supreme Court cast serious doubt on the Fifth Circuit's interpretation of article 2031b. *Hall* strongly suggests that as long as the standards of due process have been met, a nonresident defendant may be sued in Texas on a claim that is unrelated to the defendant's activities in Texas.

In *Hall* defendant Helicol, a Colombian corporation, had engaged in

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91. *Id.* at 651.

92. *Id.* at 650 (citing *Franco-Texas Land Co. v. Laigle*, 59 Tex. 339, 344 (1883)).

93. *Id.* (citing 2 W. FLETCHER, CYCLOPEDIA ON THE LAW OF PRIVATE CORPORATIONS § 385 (rev. 1982)).

94. 638 S.W.2d at 651.

95. *Id.*

96. *Greater Fort Worth & Tarrant County Community Action Agency v. Mims*, 627 S.W.2d 149, 151 (Tex. 1982).

97. TEX. REV. CIV. STAT. ANN. art. 2031b (Vernon 1964 & Supp. 1982-1983).

98. The exercise of jurisdiction over a nonresident defendant satisfies due process if the defendant has had "certain minimum contacts . . . such that the maintenance of the suit does not offend 'traditional notions of fair play and substantial justice.'" *International Shoe Co. v. Washington*, 326 U.S. 310, 316 (1945).

99. 652 F.2d 1260 (5th Cir. 1981).

100. *Id.* at 1265.

101. *Id.* at 1267. Due process does not require a nexus. See *Perkins v. Benguet Consol. Mining Co.*, 342 U.S. 437, 445-47 (1952).

102. 638 S.W.2d 870 (Tex. 1982), *cert. granted*, 103 S. Ct. 1270, 75 L. Ed. 2d 493 (1983).

extensive business activities in Texas, but these activities had no causal connection with the plaintiffs' wrongful death action. The majority nevertheless held that jurisdiction over Helicol was proper. The majority did not expressly address the question of whether article 2031b requires a nexus. It stated that the only relevant question was whether the exercise of jurisdiction over Helicol satisfied due process requirements.<sup>103</sup> The majority observed that while a nexus might be required in cases where the defendant maintained only a single contact or a few contacts with Texas, a nexus is unnecessary when, as in *Hall*, the defendant's numerous contacts with the state are such that the exercise of jurisdiction would be consistent with due process.<sup>104</sup>

The majority's failure to address specifically the statutory question is surprising in light of Justice Pope's forceful dissent. Based on the statute's language and its legislative history, Justice Pope persuasively argued that article 2031b requires a nexus.<sup>105</sup> Had the majority intended to read the nexus requirement out of the statute, one would have expected some explicit statement to that effect, or at least some discussion addressing the arguments made by the dissent. Perhaps the majority considered the defendant to have waived the statutory question, or perhaps the majority was concerned that no other convenient forum was available to the plaintiffs.<sup>106</sup> After *Hall* it appears likely that nonresident corporate defendants will be subject to suit in Texas on claims unrelated to their business activities in Texas, but a definitive answer must await future Texas Supreme Court decisions concerning article 2031b.<sup>107</sup> The Fifth Circuit, however, has apparently abandoned its holding in *Prejean v. Sonatrach, Inc.*<sup>108</sup> that article 2031b requires a nexus and now purports to follow the Texas Supreme Court's ruling in *Hall* that the exercise of jurisdiction under article 2031b extends to the limits permitted by the due process clause of the

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103. 638 S.W.2d at 871.

104. *Id.* at 872.

105. *Id.* at 877-81 (Pope, J., dissenting).

106. If Mrs. Hall could not sue Helicol in a Texas court, she would have to go to Peru or Colombia to press her claim. This prospect could not have been appealing to the majority. *See id.* at 873 (discussing *McGee v. International Life Ins. Co.*, 355 U.S. 220 (1957), in which the United States Supreme Court considered the relative convenience of the forum for the parties to the lawsuit).

107. The amenability of a nonresident corporate defendant to suit in Texas under art. 2031b was subsequently at issue in *Siskind v. Villa Foundation for Educ., Inc.*, 642 S.W.2d 434 (Tex. 1982). In *Siskind* the Texas Supreme Court did not reach the question of whether art. 2031b requires a nexus because on the facts a nexus was clearly present. The supreme court found that the plaintiff's allegations of misrepresentation and deceptive trade practices arose out of the defendant's solicitation of business in Texas. *Id.* at 436. Consequently, the *Siskind* opinion sheds no light on the ultimate resolution of the statutory question. Thus, after *Hall* and *Siskind* the reach of art. 2031b remains uncertain.

For further discussion of *Hall* and art. 2031b, see generally Weintraub, *The Fifth Circuit Wrestles with the Texas Long-Arm*, 14 TEX. TECH L. REV. 1 (1983); Comment, *Article 2031b and Rule 108 After Hall v. Helicopteros: Another Proposal*, 34 BAYLOR L. REV. 497 (1982); Note, *The Expansion of Long-Arm Jurisdiction in Texas: Hall v. Helicopteros Nacionales de Colombia, S.A.*, 36 Sw. L.J. 1197 (1983); Recent Developments, 17 TEX. INT'L L.J. 508 (1982).

108. 652 F.2d 1260 (5th Cir. 1981); *see supra* note 99-101 and accompanying text.

United States Constitution.<sup>109</sup>

In *Jim Fox Enterprises, Inc. v. Air France*,<sup>110</sup> a diversity suit, a panel of the Fifth Circuit ruled that Jim Fox Enterprises, Inc. (Fox) could acquire jurisdiction over Air France, a foreign corporation, under Federal Rule of Civil Procedure 4(d)(3)<sup>111</sup> even though Fox could not obtain jurisdiction over Air France under the state long-arm statute.<sup>112</sup> It is widely recognized, however, that rule 4(d)(3) does not provide an independent basis for acquiring jurisdiction in a diversity suit over foreign corporations because rule 4(d)(3) "deals with the manner of service and not the amenability of the corporation to service of process."<sup>113</sup> Thus, the court's interpretation of rule 4(d)(3) in *Jim Fox* appears to be improper.

*Venue.* In *Shell Oil Co. v. Sealy-Smith Foundation*<sup>114</sup> the court sustained venue against a corporate defendant whose agent or representative reestablished its presence in the county at the time the corporation's plea of privilege was heard, even though the agent was not present in the county when the suit was filed.<sup>115</sup> The court distinguished several cases in which the corporation's agent had permanently left the county before suit was filed<sup>116</sup> and analogized to a case sustaining venue against a corporation operating a seasonal business that though closed at the time suit was filed, had reopened before the court heard the plea of privilege.<sup>117</sup>

### III. SECURITIES REGULATION

*Administrative Developments.* The Securities and Exchange Commission adopted a number of important rules during the survey period. Foremost among these is the series of six rules (rules 501 to 506) collectively termed

109. *Placid Invs. v. Girard Trust Bank*, 689 F.2d 1218 (5th Cir. 1982), *vacating*, 662 F.2d 1176 (5th Cir. 1981). The Fifth Circuit vacated its earlier decision on the basis of the Texas Supreme Court's decision in *Hall*, 689 F.2d at 1219.

110. 664 F.2d 63 (5th Cir. 1981).

111. *Id.* at 65; *see* FED. R. CIV. P. 4(d)(3).

112. 664 F.2d at 65. The court found that Fox's claim was unrelated to Air France's activities in Texas, as required by *Prejean*, 652 F.2d 1260 (5th Cir. 1981). *See supra* notes 99-101 and accompanying text. In light of the Fifth Circuit's subsequent decision in *Placid Invs.* repudiating *Prejean*, *see supra* notes 108-109 and accompanying text, however, Fox would have been able to obtain jurisdiction over Air France under art. 2031b on these facts, and rule 4(d)(3) would not have been in issue.

113. 4 C. WRIGHT & A. MILLER, FEDERAL PRACTICE AND PROCEDURE § 1103, at 391 (1969); *see* *Arrowsmith v. United Press Int'l*, 320 F.2d 219 (2d Cir. 1963); *see also* Weintraub, *supra* note 107 at 11 (rule 4(d)(3) applies only to federal service of process).

114. 624 S.W.2d 643 (Tex. Ct. App.—Houston [14th Dist.] 1981, no writ).

115. *Id.* at 644. The court was construing TEX. REV. CIV. STAT. ANN. art. 1995(27) (Vernon 1964).

116. 624 S.W.2d at 646; *see* *Childers v. Pumping Sys., Inc.*, 580 S.W.2d 163 (Tex. Civ. App.—Houston [1st Dist.] 1979, no writ); *Vines v. Harry Newton, Inc.*, 445 S.W.2d 260 (Tex. Civ. App.—Houston [1st Dist.] 1969, writ *dism'd*); *City Drug Stores v. Hutson*, 121 S.W.2d 428 (Tex. Civ. App.—Amarillo 1938, no writ); *Ogburn-Dalchau Lumber Co. v. Taylor*, 126 S.W. 48 (Tex. Civ. App.—1910, no writ).

117. 624 S.W.2d at 647; *see* *Midlothian Oil & Gin Co. v. Commercial Standard Ins. Co.*, 120 S.W.2d 518 (Tex. Civ. App.—El Paso 1938, no writ).

regulation D.<sup>118</sup> Regulation D represents a significant attempt by the Commission to integrate the various exemptions for limited offerings of securities into a single regulation,<sup>119</sup> to expand the availability of the exemptive provisions, and to coordinate federal and state securities laws.<sup>120</sup>

At the heart of regulation D is the concept of the accredited investor.<sup>121</sup> Derived from rule 242,<sup>122</sup> the term "accredited investor" has been expanded in regulation D to include additional classes of institutional purchasers<sup>123</sup> and individuals whose income or net worth is substantial.<sup>124</sup> Accredited investors are presumed to be capable of evaluating the risk of investment.<sup>125</sup> Issuers claiming an exemption under regulation D may offer or sell exempted securities to an unlimited number of accredited investors.<sup>126</sup>

Rules 504, 505, and 506 embody the substantive exemptions of regulation D, replacing rules 240,<sup>127</sup> 242,<sup>128</sup> and 146,<sup>129</sup> respectively. Rule 504 exempts from federal registration the offering and sale of up to \$500,000 of securities within a twelve-month period<sup>130</sup> by an issuer that is neither a reporting company nor an investment company.<sup>131</sup> An issuer may sell se-

118. Regulation D, 17 C.F.R. §§ 230.501-.506 (1982). For comment on and analysis of regulation D, see generally Coles, *Regulation D—New Rules for Raising Capital in Non-Public Financings*, 70 ILL. B.J. 612 (1982); Parnall, Kohl & Huff, *Private and Limited Offerings After a Decade of Experimentation: The Evolution of Regulation D*, 12 N.M.L. REV. 633 (1982); Wertheimer, *Small Offerings: Recent SEC and Legislative Incentives*, 12 INST. ON SEC. REG. 285 (1981); Note, *Regulation D: Coherent Exemptions for Small Businesses Under the Securities Act of 1933*, 24 WM. & MARY L. REV. 121 (1982).

119. Regulation D is not, however, the exclusive exemption for limited offerings. See 15 U.S.C. § 77c(a)(11) (1976) (intrastate offerings); *id.* § 77d(2) (private placements); *id.* § 77d(6) (Supp. V 1981) (accredited investors); 17 C.F.R. §§ 230.251-.264 (1982) (regulation A).

120. Cf. 15 U.S.C. § 77s(c)(3)(C) (Supp. V 1981) (evidencing congressional desire to develop a uniform exemption for small issuers).

121. 17 C.F.R. § 230.501(a) (1982).

122. *Id.* § 230.242 (1982) (removed effective June 30, 1982). The term accredited investor was introduced into the Securities Act of 1933 in 1980 when subsections 2(15) and 4(6) were added to the Act. See 15 U.S.C. §§ 77b(15), 77d(6) (Supp. V 1981). The definition of accredited investor in § 4(6) was drawn from rule 242.

123. See 17 C.F.R. § 230.501(a)(1)-(3), (8) (1982).

124. Included are any individual whose net worth, or whose joint net worth with his spouse, exceeds \$1,000,000, *id.* § 230.501(a)(6), and any individual who had an income in excess of \$200,000 in the preceding two years and who expects an income of more than \$200,000 in the current year. *Id.* § 230.501(a)(7).

125. For that reason an issuer need not satisfy the rule 506 sophistication requirement with respect to accredited investors. *Id.* § 230.506(b)(2)(ii).

126. *Id.* § 230.501(e)(1)(iv).

127. *Id.* § 230.240 (removed effective June 30, 1982).

128. *Id.* § 230.242 (removed effective June 30, 1982).

129. *Id.* § 230.146 (removed effective June 30, 1982).

130. *Id.* § 230.504(b)(2). In calculating the aggregate offering price, one must deduct the aggregate offering price of all securities sold during the preceding twelve-month period in reliance on any exemption under § 3(b) of the Securities Act of 1933, 15 U.S.C. § 77c(b) (1976 & Supp. V 1981), or in violation of § 5(a) of the 1933 Act. *Id.* § 77e(a) (1976). Thus, the price of securities sold in reliance on rule 506 (or former rule 146), which was promulgated under § 4(2) of the 1933 Act, *id.* § 77d(2) (1976 & Supp. V 1981), need not be deducted.

131. 17 C.F.R. § 230.504(a) (1982).



curities exempted under rule 504 to an unlimited number of purchasers<sup>132</sup> and is under no requirement to disclose any specific information to them.<sup>133</sup> If securities are offered and sold pursuant to rule 504 exclusively in states where they are registered pursuant to state law, and if each such state requires the delivery of a disclosure document,<sup>134</sup> no restrictions exist on advertising<sup>135</sup> or resale<sup>136</sup> of the securities.

Exemption under rule 505 is available to noninvestment company issuers<sup>137</sup> for an offering or sale of up to \$5,000,000 of securities during a given twelve-month period.<sup>138</sup> Sales of securities under rule 505 are limited to thirty-five purchasers plus an unlimited number of accredited investors.<sup>139</sup> Rule 506 differs from rule 505 in two significant ways: first, there is no limit on the amount of securities that may be offered or sold under rule 506,<sup>140</sup> and second, rule 506 requires that an issuer reasonably believe that every purchaser of the securities who is not an accredited investor is "capable of evaluating the merits and risks of the prospective investment."<sup>141</sup> An issuer of securities sold under either rule 505 or rule 506 is required to disclose certain information to *all* purchasers if *any* purchaser is not an accredited investor,<sup>142</sup> and cannot sell the securities by means of general advertising or solicitation.<sup>143</sup> An issuer of securities claiming an exemption under rule 504, rule 505, or rule 506 must periodically file a form D with the SEC during the course of the offering.<sup>144</sup> The resale of securities exempted under rules 505 and 506 is restricted.<sup>145</sup>

The Commission adopted a number of other rules and regulations that deserve at least a brief mention in this survey. The Commission adopted a new rule 12g-1 providing that an issuer is not required to register securities under section 12 of the Securities Exchange Act of 1934<sup>146</sup> until the issuer has at least 500 record holders of a class of equity securities and total assets

132. Unlike rules 505 and 506, rule 504 does not limit the number of purchasers. *Compare id.* § 230.504 (unlimited number of purchasers) *with id.* § 230.505(b)(2)(ii) (no more than 35 unaccredited purchasers) *and id.* § 230.506(b)(2)(i) (same).

133. *Id.* § 230.502(b)(1)(i).

134. *Id.* § 230.504(b)(1). Texas blue sky law requires the delivery of a prospectus in connection with the offering for sale of registered securities. TEX. REV. CIV. STAT. ANN. art. 581-9(C) (Vernon 1964).

135. 17 C.F.R. § 230.502(c)(1) (1982).

136. *Id.* § 230.502(c)(2).

137. *Id.* s 230.505(a).

138. *Id.* § 230.505(b)(2)(i). The method of calculating the aggregate price under rule 505 is similar to that used under rule 504. *See supra* note 130.

139. *Id.* § 230.505(b)(2)(ii).

140. *Id.* § 230.506.

141. *Id.* § 230.506(b)(2)(ii).

142. *Id.* § 230.502(b)(1)(ii). The type of information that an issuer may be required to provide will depend on the aggregate amount of the offering. *See id.* § 230.502(b)(2)(i)(A)-(B).

143. *Id.* § 230.502(c).

144. *Id.* §§ 230.503, 239.500. Five copies of form D must be filed with the Commission no later than 15 days after the first sale of securities, every 6 months after the first sale of securities and no later than 30 days after the last sale of securities in an offering under regulation D. *Id.*

145. *Id.* § 230.502(d).

146. *See* 15 U.S.C. § 781(g) (1976).

of \$3,000,000.<sup>147</sup> The Commission also took several steps to integrate the disclosure requirements of the 1933 and 1934 Acts:<sup>148</sup> it consolidated the disclosure requirements for registration statements and periodic reports to be filed with the SEC under both Acts in regulation S-K;<sup>149</sup> it adopted three new forms (S-1, S-2 and S-3), two of which (S-2 and S-3) permit certain information to be incorporated by reference into registration statements;<sup>150</sup> and it promulgated rule 415, which provides for a delayed or continuous offering and sale of securities over a two-year period ("shelf registration").<sup>151</sup>

In response to the adoption of regulation D the Texas State Securities Board adopted a number of amendments intended to bring the exemptive provisions of Texas securities law in line with regulation D. Section 109.4<sup>152</sup> was amended primarily to accommodate the concept of the accredited investor embodied in regulation D.<sup>153</sup> Other amendments to section 109.4 make the exemption unavailable to an issuer or registered dealer who has had certain administrative, injunctive, or criminal sanctions imposed upon it.<sup>154</sup> The Securities Board also adopted new sets of rules establishing guidelines for registered public offerings of real estate<sup>155</sup> and oil and gas programs.<sup>156</sup> Both sets of rules are intended to make registration of such programs in Texas uniform with those in a number of other states.

*Texas Securities Act.* The recurring problem of defining a security under the Texas Securities Act (TSA)<sup>157</sup> arose during the survey period. In *Ben-Schoter v. State*<sup>158</sup> the Beaumont court of appeals held that an assignment of a producing, working interest in an oil well is a security within the meaning of article 581—4(A) of the TSA.<sup>159</sup> The court followed two

147. 47 Fed. Reg. 17,046 (1982) (to be codified at 17 C.F.R. § 240.12g-1).

148. For a general discussion of integrated disclosure requirements, see Schneider, *Integrated and Rationalized Disclosure Act of 1967 is Finally Adopted by the SEC*, 12 INST. ON SEC. REG. 319 (1981); Note, *Securities Regulation: Integration of Securities Offerings*, 34 OKLA. L. REV. 864 (1981).

149. 17 C.F.R. §§ 229.10-.802 (1982).

150. *Id.* §§ 239.11-.13.

151. *Id.* § 230.415. The effective date of rule 415 has been extended until Dec. 31, 1983. See [1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 83,250 (Sept. 2, 1982). For an excellent discussion of shelf registration, see Ferrara & Sweeney, *Shelf Registration Under SEC Temporary Rule 415*, 5 CORP. L. REV. 308 (1982); Gutfreund, *The SEC's Rule 415*, 121 TR. & EST., Aug. 1982, at 11.

152. 7 TEX. ADMIN. CODE § 109.4 (1982).

153. The State Securities Board adopted verbatim the definition of accredited investor from regulation D. Compare Tex. Sec. Bd., 7 Tex. Reg. 3777, 3779 (1982) (codified at 7 TEX. ADMIN. CODE § 109.4(11)(G)) with 17 C.F.R. § 239.501(a) (1982). The Board made a number of other changes in the rule to conform § 109.4 with regulation D. See Tex. Sec. Bd., 7 Tex. Reg. 3777 (1982) (codified at 7 TEX. ADMIN. CODE § 109.4).

154. Tex. Sec. Bd., 7 Tex. Reg. 3779 (1982) (codified at 7 TEX. ADMIN. CODE § 109.4(11)(B)).

155. *Id.* at 3826 (codified at 7 TEX. ADMIN. CODE §§ 117.1-.9).

156. *Id.* at 3827 (codified at 7 TEX. ADMIN. CODE §§ 121.1-.10).

157. TEX. REV. CIV. STAT. ANN. arts. 581—1 to —39 (Vernon 1964 & Supp. 1982).

158. 634 S.W.2d 28 (Tex. Ct. App.—Beaumont), *modified*, 638 S.W.2d 902 (Tex. Crim. App. 1982) (en banc).

159. TEX. REV. CIV. STAT. ANN. art. 581—4(A) (Vernon 1964).

Texas court of criminal appeals decisions<sup>160</sup> that the Texas Supreme Court had cited favorably.<sup>161</sup>

An investment contract meeting the test of *SEC v. W.J. Howey Co.*<sup>162</sup> has been held to be a security under the TSA.<sup>163</sup> The *Howey* test requires that there be an investment in a common enterprise with the expectation of profit to be derived solely from the efforts of others.<sup>164</sup> In *Cross v. DFW South Entry Partnership*<sup>165</sup> the issue was whether a purchase of land was an investment contract under *Howey*. Based on representations made by Charles Cross, Ronald G. Corley entered into a contract to purchase a piece of land from the property's legal trustee, Bea Cross. Corley signed the contract in his capacity as trustee for a general partnership that he subsequently formed. The partnership agreement provided for the appointment of a manager. A corporation with which Charles Cross was purportedly associated was named as manager by an endorsement on the partnership agreement itself. The partnership agreement expressly reserved to the partnership the right to terminate the management contract.

Alleging that the sale of the land constituted an investment contract, the partnership sued the Crosses for failing to register the sale as a security in violation of the TSA. Applying the *Howey* test the court of appeals held for the Crosses. The court summarily disposed of the partnership's claim against Bea Cross because it found no evidence that the partnership was involved with her in a common scheme, or that the success of the enterprise depended solely upon her efforts.<sup>166</sup> The court engaged in a more extensive analysis in assessing the claim against Charles Cross. Although it was Charles Cross who had persuaded the partnership to purchase the land, the court found that fact insufficient to involve Charles Cross and the partnership in a common enterprise.<sup>167</sup> Furthermore, the court found that the partnership retained ultimate control over its investment and profits in two ways: first, by reserving the right to terminate the management contract, and second, by giving the manager a one-time fee rather than a share of the profits.<sup>168</sup> Thus, the success of the enterprise could not be said to depend solely on Charles Cross's efforts, even assuming he was associated with the corporate manager.<sup>169</sup> Accordingly, the court held that the general partnership had not purchased a security.<sup>170</sup>

In a recent development related to the TSA a federal district court in

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160. *Muse v. State*, 137 Tex. Crim. 622, 132 S.W.2d 596, 597 (1939); *Atwood v. State*, 135 Tex. Crim. 543, 121 S.W.2d 353 (1938).

161. See *Kadane v. Clark*, 135 Tex. 496, 143 S.W.2d 197 (1940).

162. 328 U.S. 293 (1946).

163. *Searsy v. Commercial Trading Corp.*, 560 S.W.2d 637 (Tex. 1977).

164. 328 U.S. at 301.

165. 629 S.W.2d 860 (Tex. Ct. App.—Dallas 1982, no writ).

166. *Id.* at 863-64.

167. *Id.* at 864.

168. *Id.* at 865. The court distinguished this case from *Howey*, in which the managerial contract was irrevocable for ten years and the manager shared in the profits. *Id.* at 864. See also *Williamson v. Tucker*, 632 F.2d 579, 599 (5th Cir. 1980).

169. 629 S.W.2d at 865.

170. *Id.*

*Allais v. Donaldson Lufkin & Jenrette*<sup>171</sup> held that a plaintiff could not maintain a suit under the Texas Deceptive Trade Practices Act (DTPA)<sup>172</sup> against a securities dealer for misrepresentations made in connection with the purchase or sale of a security.<sup>173</sup> The court correctly reasoned that to allow a plaintiff to bring suit against securities dealers under the DTPA, which provides no good faith defense, would emasculate the due diligence defense afforded securities dealers under the TSA and render dealers strictly liable for their misrepresentations.<sup>174</sup> Reading the statutes in pari materia, the court ruled that the TSA, which specifically pertains to misrepresentations in securities transactions, had to prevail over the more general DTPA,<sup>175</sup> notwithstanding the saving of remedies clause in the TSA.<sup>176</sup>

*Section 16(b) Liability.* Although section 16(b) of the Securities Exchange Act of 1934<sup>177</sup> requires a corporate insider<sup>178</sup> to disgorge the profits he obtains from the purchase and sale, or sale and purchase, of the corporation's securities within a six-month period, not every purchase and sale, or sale and purchase, within the statutory time period will result in the insider's liability. In *Kern County Land Co. v. Occidental Petroleum Corp.*<sup>179</sup> the United States Supreme Court created a defense to section 16(b) liability. Under *Kern County* the presumption of liability under section 16(b) may be rebutted if (1) the transaction at issue is "unorthodox"<sup>180</sup> and (2) if the particular circumstances of the transaction do not suggest the kind of speculative abuse of inside information at which section 16(b) is aimed.<sup>181</sup>

In *Pier 1 Imports of Georgia, Inc. v. Wilson*<sup>182</sup> the defendant, Rayland Wilson, successfully invoked the *Kern County* defense. Wilson was the executive vice-president of Pirvest, Inc.,<sup>183</sup> a retail operation. At the directive of Pirvest's president, Luther Henderson, Wilson sold all of his shares

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171. 532 F. Supp. 749 (S.D. Tex. 1982).

172. TEX. BUS. & COM. CODE ANN. §§ 17.01-.63 (Vernon 1968 & Supp. 1982-1983).

173. 532 F. Supp. at 752. An earlier decision had held that a sale of securities was not a sale of goods under the DTPA, *Portland Sav. & Loan Ass'n v. Beville, Bresler & Schulman Gov't Sec., Inc.*, 619 S.W.2d 241, 245 (Tex. Civ. App.—Corpus Christi 1981, no writ), but no Texas Court had decided whether a stockbroker's advising a client constituted a rendering of services under the DTPA. See *Allais*, 532 F. Supp. at 751.

174. 532 F. Supp. at 751-52. Similarly, the court concluded that a plaintiff would be able to circumvent the scienter requirement, see *Wood v. Combustion Eng'g, Inc.*, 643 F.2d 339, 345 (5th Cir. 1981), of the Texas general fraud statute, TEX. BUS. & COM. CODE ANN. § 27.01 (Vernon 1968), if he could bring a suit against securities dealers under the DTPA. 532 F. Supp. at 752.

175. 532 F. Supp. at 752.

176. TEX. REV. CIV. STAT. ANN. art. 581—33M (Vernon Supp. 1982-1983).

177. 15 U.S.C. § 78p(b) (1976).

178. For the purpose of § 16, a corporate insider is a director or an officer of an issuer corporation or a person who owns more than 10% of any class of any registered equity security, other than an exempted security, of such corporation. *Id.* § 78p(a).

179. 411 U.S. 582 (1973).

180. *Id.* at 593 (citing 2 L. LOSS, SECURITIES REGULATION 1069 (2d ed. 1961)).

181. 411 U.S. at 600.

182. 529 F. Supp. 239 (N.D. Tex. 1981).

183. Pirvest was a successor corporation to Pier 1 Imports of Georgia, Inc.

of Pirvest, including shares that he had purchased within the preceding six months, pursuant to a tender offer for Pirvest stock made by Pier 1 Acquisition, Inc. Pier 1 Acquisition had negotiated the terms of the tender offer exclusively with Henderson. Having successfully concluded its tender offer, Pier 1 Acquisition exchanged the Pirvest shares that it had obtained for substantially all of Pirvest's assets, whereupon Pirvest discontinued its retail operations and became engaged in the business of trading in securities. After the sale of Pirvest's assets to Pier 1 Acquisition, Henderson owned eighty percent of the then-outstanding shares of Pirvest stock.

In a suit on Pirvest's behalf to recover the profits that Wilson had allegedly obtained in violation of section 16(b), the federal district court examined Wilson's sale in light of *Kern County*. The court first held that the transaction was unorthodox because Wilson had sold his shares pursuant to a tender offer, and because Wilson would have owned stock in a company that was essentially a holding company controlled by Henderson had Wilson not sold his shares.<sup>184</sup> Turning to the second prong of the *Kern County* test the court found that this specific transaction did not present the opportunity for speculative abuse.<sup>185</sup> Although Wilson's position as executive vice-president raised an inference that he had access to inside information,<sup>186</sup> this inference was effectively rebutted by stipulations that Wilson had not participated in negotiations concerning the tender offer, had no knowledge of the tender offer until it was made public, and had otherwise been essentially excluded from the inner workings of the Pirvest management.<sup>187</sup> Thus, the court held that since Wilson could not possibly have abused his alleged insider position, he was not required to disgorge the profits he had realized from the sale of his Pirvest stock.<sup>188</sup> As a practical matter the court observed that Pirvest's counsel had, in effect, conceded away Pirvest's claim by stipulating to a number of facts that were determinative under the *Kern County* rationale.<sup>189</sup>

*Section 17(a) of the 1933 Act.* Although the United States Supreme Court in *Blue Chip Stamps v. Manor Drug Stores*<sup>190</sup> expressly reserved the issue of whether to infer a private right of action under section 17(a) of the Securities Act of 1933,<sup>191</sup> a Texas federal district court<sup>192</sup> joined other district

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184. *Id.* at 243; *see also* SEC v. Texas Int'l Co., 498 F. Supp. 1231 (N.D. Ill. 1980) (corporate reorganization is an unorthodox transaction under short-swing sale provisions of securities laws); Makofsky v. Ultra Dynamics Corp., 383 F. Supp. 631 (S.D.N.Y. 1974) (tender offer is an unorthodox transaction under short-swing sale provisions of securities law).

185. 529 F. Supp. at 243.

186. *Id.* at 244 (citing *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Livingston*, 566 F.2d 1119, 1121-22 (9th Cir. 1978)).

187. 529 F. Supp. at 244-45; *see* *Gold v. Sloan*, 486 F.2d 340, 349 (4th Cir.), *cert. denied*, 419 U.S. 873 (1974).

188. 529 F. Supp. at 244.

189. *Id.* at 245.

190. 421 U.S. 723 (1975).

191. *Id.* at 752 n.15; *see* 15 U.S.C. § 77q(a) (1976). *See generally* Scholl & Perkowski, *An Implied Right of Action Under Section 17(a): The Supreme Court Has Said "No," But Is Anybody Listening?*, 36 U. MIAMI L. REV. 41 (1981).

192. *Keys v. Wolfe*, 540 F. Supp. 1054 (N.D. Tex. 1982).

courts in the Fifth Circuit<sup>193</sup> in refusing to infer such a right. Given the Supreme Court's reluctance in two recent cases to infer a private right of action under other securities statutes,<sup>194</sup> the district court surmised that the Supreme Court would adopt the same posture with respect to section 17(a) in the absence of any indication that Congress had intended to provide a private cause of action under section 17(a).<sup>195</sup>

*Rule 10b-5 and the Express Remedy Provisions of the Securities Acts.* The issue of whether an implied right of action is available under rule 10b-5<sup>196</sup> when another section of the securities laws provides an express remedy for the same proscribed conduct is a subject of continuing interest in the Fifth Circuit. Last year in *Huddleston v. Herman & MacLean*<sup>197</sup> the Fifth Circuit considered the relationship between rule 10b-5 and the express remedies provided by sections 11 and 12(2) of the Securities Act of 1933.<sup>198</sup> This year, in *Chemetron Corp. v. Business Funds, Inc.*,<sup>199</sup> the court confronted the question of whether an implied remedy under rule 10b-5 is available for damages resulting from a price manipulation scheme that is encompassed by the express remedy of section 9 of the Securities Exchange Act of 1934.<sup>200</sup>

Chemetron Corporation had acquired stock in Western Equities, Inc. (Westec) in exchange for Chemetron's interest in one of its subsidiaries. After Westec failed Chemetron brought suit to recover the losses it suffered as a consequence of the transaction. Chemetron alleged that the defendant had engaged in a scheme to drive up the price of Westec stock, and had either misrepresented the nature of the scheme, or failed to disclose material facts about the scheme to Chemetron in violation of section 9, section 10(b), and rule 10b-5. The jury found that the defendant engaged in a manipulative stock scheme and that the defendant did not disclose the scheme to Chemetron, but it was not persuaded that the stock scheme had affected the price that Chemetron paid for Westec stock, a necessary element of a section 9 claim.<sup>201</sup> Consequently, Chemetron could not recover under section 9. Given the jury's other findings, however, the trial court entered judgment in favor of Chemetron on its rule 10b-5 claim.

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193. See *Martin v. Howard, Weil, Labouisse, Friedrichs, Inc.*, 487 F. Supp. 503 (E.D. La. 1980); *Gunter v. Hutcheson*, 433 F. Supp. 42 (N.D. Ga. 1975).

194. See *Transamerica Mortgage Advisers, Inc. v. Lewis*, 444 U.S. 11, 19 (1979) (no private right of action under § 206 of the Investment Adviser's Act of 1940); *Touche Ross & Co. v. Redington*, 442 U.S. 560, 569 (1979) (no private right of action under section 17(a) of the Securities Exchange Act of 1934).

195. 540 F. Supp. at 1059-60.

196. 17 C.F.R. § 240.10b-5 (1982).

197. 640 F.2d 534 (5th Cir. 1981), *modified*, 650 F.2d 815 (5th Cir. 1982), *aff'd in part, rev'd in part and remanded*, 103 S. Ct. 683, 74 L. Ed. 2d 548 (1983).

198. 15 U.S.C. §§ 77k, 77l(2) (1976).

199. 682 F.2d 1149 (5th Cir. 1982).

200. 15 U.S.C. § 78i (1976).

201. Section 9(e) of the Securities Exchange Act of 1934 provides an express remedy for any person who shall purchase or sell any security at a price which was affected by conduct violating subsections (a), (b) or (c) of § 9. *Id.* § 78i(e).

In order to determine whether a rule 10b-5 implied cause of action was available, the Fifth Circuit followed the method of analysis it had previously adopted in *Huddleston*.<sup>202</sup> Under the *Huddleston* approach a court must ascertain whether rule 10b-5 requires the plaintiff to prove additional facts not necessary for recovery under the express cause of action; if it does, then a rule 10b-5 implied action is available.<sup>203</sup>

Comparing the elements of a rule 10b-5 claim with those of a claim under section 9, the majority in *Chemetron* concluded that rule 10b-5 does not require a plaintiff to prove facts beyond those required by the pertinent subsections of section 9.<sup>204</sup> Because rule 10b-5 imposes a lesser burden of proof than does section 9, the court reasoned that permitting a plaintiff to recover under rule 10b-5 would effectively nullify Congress's deliberate and careful limitations on section 9's express statutory remedy.<sup>205</sup> The majority, therefore, reversed the judgment in favor of Chemetron on its rule 10b-5 claim.<sup>206</sup> A strongly-worded dissent objected to the idea that a defendant who had been found to violate rule 10b-5 should escape liability for his wrongdoing only because he had not violated section 9.<sup>207</sup>

*Statute of Limitations in Section 10(b) Actions in Texas.* Two years ago the Fifth Circuit decided in *Wood v. Combustion Engineering, Inc.*<sup>208</sup> that the two-year statute of limitations under the Texas general fraud statute,<sup>209</sup> rather than the three-year limitations period of the Texas blue sky law then in effect,<sup>210</sup> was applicable to private actions in Texas brought under section 10(b) of the Securities Exchange Act of 1934.<sup>211</sup> The Fifth Circuit reasoned that the general fraud statute more closely resembled section 10(b) because both statutes required a plaintiff to prove reliance and scienter, whereas the Texas Securities Act did not.<sup>212</sup> This year, in *Keys v. Wolfe*,<sup>213</sup> a federal district court reexamined the section 10(b) statute of limitations question in light of the 1977 amendments to the Texas Securities Act,<sup>214</sup> which had not been considered in *Wood*. Because those amendments did not affect the important considerations of reliance and

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202. 682 F.2d at 1159; see *Huddleston v. Herman & MacLeon*, 640 F.2d 534 (5th Cir. 1981), *modified*, 650 F.2d 815 (5th Cir. 1982), *aff'd in part, rev'd in part, and remanded*, 103 S. Ct. 683, 74 L. Ed. 2d 548 (1983).

203. 682 F.2d at 1160.

204. *Id.* at 1162 (comparing rule 10b-5 with subsection 9(a)(4)); *id.* at 1165 (comparing rule 10b-5 with subsections 9(a)(1), (2) and (6)).

205. *Id.* at 1163 (with respect to subsection 9(a)(4)); *id.* at 1165 (with respect to subsections 9(a)(1), (2) and (6)).

206. *Id.* at 1170.

207. *Id.* at 1195 (Williams, J., dissenting); see also Aldave, *Neither Unusual Nor Unfortunate: The Overlap of Rule 10b-5 with the Express Liability Sections of the Securities Acts*, 60 TEX. L. REV. 709, 738-39 (1982) (existence of express right of action under § 9 should not bar implied right of action under rule 10b-5).

208. 643 F.2d 339 (5th Cir. 1981).

209. TEX. BUS. & COM. CODE ANN. § 27.01 (Vernon 1968).

210. TEX. REV. CIV. STAT. ANN. art. 581-33 (Vernon 1964).

211. 643 F.2d at 342; see 15 U.S.C. § 78j(b) (1976).

212. 643 F.2d at 344-45.

213. 540 F. Supp. 1054 (N.D. Tex. 1982).

214. TEX. REV. CIV. STAT. ANN. art. 581-33 (Vernon Supp. 1982-1983).

scienter, the court concluded that the two-year statute still applies to actions brought under section 10(b) in Texas.<sup>215</sup>

*"Purchase or Sale" Under Section 10(b).* The question of whether a repurchase transaction is a purchase or sale of a security within the meaning of section 10(b) was before the Fifth Circuit for the first time in *First National Bank v. Estate of Russell*.<sup>216</sup> Although the Fifth Circuit had previously characterized a repurchase transaction in another context as "essentially a short-term collateralized loan,"<sup>217</sup> the court in *Russell* cautioned that that description was not determinative for section 10(b) purposes.<sup>218</sup> Observing that a fact finder could have found the repurchase transaction to be a purchase or sale, the court held that summary judgment was improper, without expressing an opinion on whether "as a matter of law, a repurchase transaction is a purchase or sale within the meaning of the 1934 Act."<sup>219</sup>

*Section 29(b) Right to Rescission.* Section 29(b) of the Securities Exchange Act of 1934 renders voidable "[e]very contract made in violation of [the 1934 Act] . . . and every contract . . . the performance of which involves the violation of . . . any provision of [the 1934 Act] . . ." <sup>220</sup> In *Regional Properties, Inc. v. Financial & Real Estate Consulting Co.* <sup>221</sup> the Fifth Circuit canvassed a number of issues concerning this rarely litigated provision. The court first held that section 29(b) implies a private right of action for rescission,<sup>222</sup> and outlined the necessary elements of a section 29(b) cause of action: (1) the contract must involve a prohibited transaction; (2) the person seeking rescission must be in contractual privity with the defendant; and (3) the person seeking rescission must be in the "class of persons the Act was designed to protect."<sup>223</sup> The court then determined that all the traditional equitable defenses are available to a section 29(b) cause of action.<sup>224</sup> Finally, with regard to remedies, the court concluded

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215. 540 F. Supp. at 1064. The statute of limitations for the Texas blue sky laws now provides: "(2) No person may sue under Section 33A(2) [the antifraud section] . . . (a) more than three years after discovery of the untruth or omission, or after discovery should have been made by the exercise of reasonable diligence; or (b) more than five years after the sale . . ." TEX. REV. CIV. STAT. ANN. art. 581—33H (Vernon Supp. 1982-1983).

216. 657 F.2d 668 (5th Cir. 1981). A repurchase transaction involves a sale of securities coupled with an agreement by the seller to repurchase securities of the same description at a later date.

217. *Westchester County Sav. & Loan Ass'n v. Legel, Braswell Gov't Sec. Corp.*, 648 F.2d 321, 324 n.5 (5th Cir. 1981) (quoting *SEC v. Miller*, 495 F. Supp. 465, 467 (S.D.N.Y. 1980)).

218. 657 F.2d at 673 n.17.

219. *Id.* at 676 n.24.

220. 15 U.S.C. § 78cc(b) (1976).

221. 678 F.2d 552 (5th Cir. 1982).

222. *Id.* at 558.

223. *Id.* at 559 (citing *Eastside Church of Christ v. National Plan, Inc.*, 391 F.2d 357, 362 (5th Cir.), *cert. denied*, 393 U.S. 913 (1968)). The court found that the class of persons the Act was designed to protect should be broadly construed to extend beyond those who buy securities. 678 F.2d at 561.

224. 678 F.2d at 562.



that the policy underlying section 29(b) precluded a person who had violated the 1934 Act from collecting fees that had not been paid to him, but did not bar his retaining fees he had received for services he had already performed.<sup>225</sup>

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225. *Id.* at 564.