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## Corporations and Partnerships

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# CORPORATIONS AND PARTNERSHIPS

by

Robert W. Hamilton \*

THE most significant developments during the current survey period in the area of corporations and partnerships were legislative. In 1983 the Texas Legislature made several changes in the Texas Business Corporation Act that materially increase its usefulness in a modern complex commercial and corporate economy.<sup>1</sup> While these changes may be viewed as narrow and technical since they deal with arcane issues such as indemnification and "safe harbors" for dividend declarations, their substantive significance and practical importance should not be understated. In addition to these legislative developments there were several interesting and important judicial decisions during the survey period.

## I. LEGISLATIVE DEVELOPMENTS

### A. Indemnification

For many years Texas has struggled with a primitive indemnification statute that was based on the 1950 Model Business Corporation Act.<sup>2</sup> In the last decade the volume of litigation involving corporate directors and officers has increased dramatically; the cost of such litigation has increased even more dramatically. Indemnification permits these litigation costs to be borne by the corporation rather than the individual officer or director if the officer or director can establish either his lack of responsibility or good faith.<sup>3</sup> The policy argument in favor of a broad indemnification statute is quite compelling: if desirable persons are to be persuaded to accept direc-

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1. Most of these changes were proposed by the Section on Corporation, Banking and Business Law of the Texas Bar Association. *See Annual Reports*, 45 TEX. B.J. 908, 908 (1982). In proposing these and other amendments the committee repeatedly emphasized the importance of keeping the Texas corporation statutes modern and up-to-date in order to avoid the flight of Texas corporations to more hospitable jurisdictions, such as Delaware.

2. TEX. BUS. CORP. ACT ANN. art. 2.02, § A(16) (Vernon 1980) (amended 1983). The major saving grace of the pre-1983 Texas statute was its nonexclusive character. Careful attorneys, therefore, could place more modern indemnification provisions in articles of incorporation or bylaws of Texas corporations.

3. *See generally* J. BISHOP, THE LAW OF CORPORATE DIRECTORS AND OFFICERS: INDEMNIFICATION AND INSURANCE (1981) (thorough examination of indemnification); W. KNEPPER, LIABILITY OF CORPORATE OFFICERS AND DIRECTORS 587-618 (1978) (discussion of indemnification). The precise scope of the indemnification right is, of course, the major policy issue relating to indemnification.

torships, they must be given assurance that their personal assets will not be depleted by the cost of defending claims that often turn out to be groundless. Restrictions, however, must be imposed on the power of indemnification to assure that persons engaged in clearly improper conduct are not protected by corporate funds from the consequences of their wrongdoing. The 1950 Model Act provision did not adequately address the problem of the balance between these competing considerations. Earlier attempts to enact statutes in Texas similar to those adopted in Delaware and other important corporate states during the mid-1960s, however, foundered on the shoals of domestic Texas politics.<sup>4</sup>

The Texas Bar Association Committee addressing the indemnification issue originally planned to follow section 145 of the Delaware statute.<sup>5</sup> Shortly before the committee began serious work on the indemnification provision, however, a revised version of section 5 of the Model Business Corporation Act was published in 1980, which sought to resolve unanticipated problems that had arisen under statutes similar to the Delaware statute.<sup>6</sup> The committee decided to follow the Model Act version with only relatively minor stylistic and clarifying changes. The committee proposal was adopted by the Texas Legislature during the 1983 session.<sup>7</sup>

The basic policy issue that must be addressed by every indemnification statute is to limit indemnification to situations where it will further accepted corporate goals and to prohibit it where it might protect or encourage wrongful or improper conduct. One commentator neatly encompassed this fundamental issue when he stated that the goal of indemnification is to "seek the middle ground between encouraging

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4. Candor compels me to state that I personally testified against some of the earlier versions of this legislation, and the 1983 statute contains some of the provisions objected to earlier. On balance the version adopted in 1983 seems clearly superior to the versions that failed of enactment in Texas, though perhaps my perspective on some of these problems may have softened over time. I nevertheless continue to believe, as indicated below, that some of the provisions contained in modern indemnification statutes, including the new Texas statute, are too liberal.

5. DEL. CODE ANN. tit. 8, § 145 (1983).

6. The draft of § 5 was first proposed for comment in 1979. See Committee on Corporate Laws, *Changes in the Model Business Corporation Act Affecting Indemnification of Corporate Personnel*, 34 BUS. LAW. 1595 (1979). The final version appears in Committee on Corporate Laws, *Changes in the Model Business Corporation Act Affecting Indemnification of Corporate Personnel*, 36 BUS. LAW. 99 (1980) [hereinafter cited as *Indemnification of Corporate Personnel*]. At about the same time the Committee on Corporate Law of the American Bar Association and the American Bar Foundation commissioned the development of a new version of the Model Business Corporation Act and a multivolume treatise, THE MODEL BUSINESS CORPORATION ACT ANNOTATED. The new version of the Model Act did not change the substance of § 5, which served as the model for the Texas statute. The new version did, however, reorganize § 5 in an effort to make it simpler and more understandable. I served as reporter for this major revision of the Model Act and for the creation of the new annotated volumes. The bulk of the work was done by a staff at the University of Texas funded by the American Bar Foundation and the American Bar Association, with significant support and accounting services provided by the University of Texas Law School and the University of Texas Law School Foundation. The new Model Act should become publicly available in 1984.

7. Texas Business Corporation Act, ch. 540, § 2, 1983 Tex. Gen. Laws 3140, 3143-50 (codified at TEX. BUS. CORP. ACT ANN. art. 2.02—1 (Vernon Supp. 1984)).

fiduciaries to violate their trust, and discouraging them from serving at all."<sup>8</sup> The new article 2.02—1 of the Texas Business Corporation Act addresses this basic issue by creating different standards for different kinds of conduct.

1. *A defendant who has been totally successful in the proceeding.* A person who is a party to a proceeding because he is a director is entitled to indemnification as a matter of right if he was "wholly successful, on the merits or otherwise, in the defense of the proceedings."<sup>9</sup> The word "wholly" was added to avoid the holding in *Merritt-Chapman & Scott Corp. v. Wolfson*<sup>10</sup> that a director may be entitled as a matter of right to partial indemnification if he succeeded in obtaining dismissal of some counts of an indictment as a result of a plea bargain even though he pleaded nolo contendere with respect to others.<sup>11</sup> The phrase "or otherwise" means that a defendant-director who obtains dismissal of a suit on a procedural or nonsubstantive ground, such as the statute of limitations or the grant of immunity in a criminal prosecution, is nevertheless entitled to indemnification as a matter of right. This latter principle was retained in the Model Act revision after vigorous debate within the Committee on Corporate Laws. The proponents argued that a person who has a valid procedural defense should not be required to proceed to the equivalent of a trial on the merits, which may be prolonged and expensive, in order to establish eligibility for mandatory indemnification.<sup>12</sup> If a director is entitled to indemnification because he was successful "on the merits or otherwise" but finds it necessary to go to court to obtain that indemnification (because, for example, there has been a change in management in the corporation in the interim), he may also recover the expenses incurred in securing the indemnification.<sup>13</sup>

The right of indemnification of the successful director is thus absolute. This entitlement to indemnification, however, may be eliminated or restricted by appropriate provision in the articles of incorporation.<sup>14</sup> This option was included to take account of unusual situations such as a newly

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8. Johnston, *Corporate Indemnification and Liability Insurance for Directors and Officers*, 33 BUS. LAW. 1993, 1994 (1978).

9. TEX. BUS. CORP. ACT ANN. art. 2.02—1, § H (Vernon Supp. 1984).

10. 321 A.2d 138 (Del. 1974).

11. *Id.* at 142.

12. See *Indemnification of Corporate Personnel*, *supra* note 6, at 113. On the other hand, one can equally well posit situations in which the defendant's procedural defense, such as the statute of limitations, may mask undisputed misconduct. Similarly, a criminal defendant who is granted immunity to testify against his co-officers would appear to be entitled to indemnification as a matter of right. This is one issue on which I continue to believe that modern indemnification statutes are too liberal. I see no reason why it would be impractical to require some kind of preliminary showing that a defendant who has prevailed on the basis of a procedural defense or a grant of immunity was not involved in improper conduct as a prerequisite for indemnification. The California indemnification statute does not include the words "or otherwise." See CAL. CORP. CODE § 317(d) (West 1977).

13. TEX. BUS. CORP. ACT ANN. art. 2.02—1, § I (Vernon Supp. 1984). As a result of this provision, new management will likely not refuse to grant indemnification to a former director who is entitled to indemnification.

14. See *id.* § U. For additional discussion of this provision, see *infra* note 78 and accompanying text.

formed corporation wishing to protect its limited assets against dissipation through payment of indemnification. As a practical matter, however, indemnification of the successful director is the clearest example of desirable indemnification and it is probably unlikely that the option to exclude such indemnification will be widely elected.

2. *The director who has been held liable to the corporation or has been found to have obtained an "improper personal benefit."* Generally, a director who has been found liable to the corporation, or to a third party in a proceeding in which it was found "that personal benefit was improperly received by him," is not entitled to indemnification.<sup>15</sup> The prohibition against indemnification when an improper personal benefit is involved was added to the statute to counter criticism that the statute literally permitted indemnification of directors or officers who incurred liability in connection with share transactions, particularly under rule 10b-5<sup>16</sup> or section 16(b) of the Securities Exchange Act of 1934.<sup>17</sup> Even if a director received an "improper personal benefit," however, he may petition a court of competent jurisdiction that he "is fairly and reasonably entitled to indemnification in view of all the relevant circumstances," and the court may order indemnification in its discretion.<sup>18</sup> A director who has been found liable to a third person where the transaction does not involve an "improper personal benefit" may be entitled to discretionary indemnification on the basis of the standards described immediately below.<sup>19</sup>

3. *The director who settles, pleads nolo contendere, or is found liable to a third person, but does not receive an improper personal benefit.* The eligibility of the settling director for indemnification is of tremendous practical importance. A great deal of modern corporate litigation in which claims for indemnification arise does not terminate by a definite finding of liability or of nonliability. For example, most derivative litigation is settled before judgment. The same is also true of much civil litigation brought by the Securities and Exchange Commission. It also includes, moreover, two other important categories of cases: those in which the director has been held liable to third persons but has not received an "improper personal benefit" under article 2.02—1, section C, and cases involving criminal prosecutions. In all of these cases indemnification is discretionary with the corporation; however, a director who is denied indemnification under these tests has the privilege of seeking to persuade a court of competent jurisdiction that he is "fairly and reasonably entitled to indemnification in

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15. TEX. BUS. CORP. ACT ANN. art. 2.02—1, § C (Vernon Supp. 1984).

16. 17 C.F.R. § 240.10b-5 (1983).

17. 15 U.S.C. § 78p(b) (1982). Under § 145 of the Delaware statute and similar statutes in other states, the indemnification of such persons appears to be expressly authorized by the statute that permitted indemnification in suits brought by third parties if the director could establish that his conduct "was not opposed" to the best interests of the corporation. DEL. CODE ANN. tit. 8, § 145 (1983).

18. TEX. BUS. CORP. ACT ANN. art. 2.02—1, § J (Vernon Supp. 1984).

19. See *infra* note 20 and accompanying text.

view of all the relevant circumstances.”<sup>20</sup> Many corporations, furthermore, commit themselves in advance by contract or bylaw provision to provide indemnification in all cases where discretionary indemnification is permitted.<sup>21</sup> The Texas indemnification statute considers in detail two questions: (1) what standards should be applied to determine whether indemnification is permissible, and (2) who should determine whether or not the standards were met.

*a. Substantive standards.* The substantive standard for permitting discretionary indemnification in these categories is that the director must have:

- (1) conducted himself in good faith; and
- (2) reasonably believed:
  - (a) in the case of conduct *in his official capacity as a director* of the corporation, that his conduct was in the corporation’s best interest; and
  - (b) in all other cases, that his conduct was at least not opposed to the corporation’s best interests; and
  - (c) in the case of any criminal proceeding, had no reasonable cause to believe his conduct was unlawful.<sup>22</sup>

The issue of whether a director is acting in his “official capacity” is of particular importance since this issue determines whether the standard applicable is the director’s reasonable belief that “his conduct was in the corporation’s best interest” or the less onerous standard that “his conduct was at least not opposed to the corporation’s best interest.”<sup>23</sup> Article 2.01—2, section A(4) defines “official capacity” to exclude service by the director at the corporation’s request in a variety of satellite positions, such as with trade associations, with subsidiary or affiliated corporations, or as a trustee of an employee’s pension trust.<sup>24</sup> In all of these instances a director may be indemnified by the corporation by reason of his activities in the satellite position so long as his action was “not opposed to” the corporation’s interest.<sup>25</sup> The same standard also applies to a director’s general profit making activities, such as securities market transactions,<sup>26</sup> that are not connected with his service as director.

The availability of discretionary indemnification in criminal proceedings raises problems that are of more theoretical than practical concern. The rule that a criminal defendant who is found guilty may be entitled to

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20. TEX. BUS. CORP. ACT ANN. art. 2.02—1, § J (Vernon Supp. 1984).

21. See *infra* notes 76-78 and accompanying text.

22. TEX. BUS. CORP. ACT ANN. art. 2.02—1, § B (Vernon Supp. 1984) (emphasis added). The Model Act provision from which the Texas statute was derived is identical in substance. See MODEL BUS. CORP. ACT § 5(a) (1979).

23. TEX. BUS. CORP. ACT ANN. art. 2.02—1, § B(2)(a)-(b) (Vernon Supp. 1984).

24. *Id.* § A(4).

25. *Id.* § B(2)(b).

26. The improper personal benefit exclusion further qualifies the “not opposed to” standard and prevents a director from obtaining indemnification from the corporation in most securities transactions.

indemnification from the corporation of the amount of the fine if he "had no reasonable cause to believe his conduct was unlawful"<sup>27</sup> is certainly questionable from a theoretical standpoint. When the state elects to impose a criminal fine on a defendant even though he did not know the action was unlawful, a corporation should not second-guess the state and reimburse the defendant for the amount of the fine. On the other hand, this principle will probably have little practical import. As a passing note, indemnification under this standard seems clearly impermissible in connection with traffic fines and other petty offenses where the person knew his action was unlawful but realized that it was not very serious.<sup>28</sup>

*b. Who determines eligibility.* An issue at least as important as the standards themselves is who should make the determination that a director meets the standards and is eligible for discretionary indemnification. Article 2.01—2, section F authorizes eligibility determination to be made by (1) the board of directors, (2) a committee of the board, (3) the shareholders, or (4) independent legal counsel.<sup>29</sup>

The directors who are not named defendants may authorize indemnification by a majority vote, if they constitute a quorum.<sup>30</sup> Where a quorum may be obtained, this is likely to be the favored method of securing approval because it is simple, inexpensive, and involves only action by the board.

If a quorum of disinterested directors cannot be obtained, eligibility for indemnification may be approved by a majority vote of a committee consisting of two or more directors who at the time of the vote are not named defendants in the proceeding.<sup>31</sup> A committee may be utilized only when a quorum of the entire board eligible to authorize indemnification is impossible to obtain.<sup>32</sup> Since a committee may consist of as few as two directors, it is always possible to obtain board determination of indemnification so long as there are two or more directors who have not been named as defendants in the proceeding. The entire board, including the directors who are parties to the proceeding, may participate in the selection of this committee, so that a quorum for the appointment of the committee may always be obtainable. This minor degree of involvement in the selection process by interested directors is arguably justified by a principle of necessity and by recognition that committee selection does not involve direct substantive involvement by the interested directors. Alternatively, the shareholders may authorize indemnification in a vote "that excludes the shares held by directors who are named defendants" in the proceeding.<sup>33</sup>

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27. TEX. BUS. CORP. ACT ANN. art. 2.02—1, § B(3) (Vernon Supp. 1984).

28. Officers and employees who are not directors may be able to have these fines reimbursed since the statutory indemnification provided by art. 2.02—1 is not exclusive as to them. *See infra* note 56 and accompanying text.

29. TEX. BUS. CORP. ACT ANN. art. 2.02—1, § F (Vernon Supp. 1984).

30. *Id.* § F(1) (Vernon Supp. 1984).

31. *Id.* § F(2).

32. *Id.*

33. *Id.* § F(4).

Finally, indemnification may be authorized by "special legal counsel" selected either by the board or a committee by a vote that would have authorized indemnification as an original matter.<sup>34</sup> If an appropriate quorum of directors cannot be obtained, and if two uninvolved directors are not available, special legal counsel may be selected by a majority vote of all the directors, including the involved directors.<sup>35</sup> Thus, no situation exists in which shareholder approval must be obtained before indemnification may be authorized.

4. *Miscellaneous issues.* The new Texas indemnification statute addressed several other issues relating to discretionary indemnification. Many of these issues were not addressed at all by earlier indemnification statutes, including the Texas Business Corporation Act and the Delaware General Corporation Law. These issues include the following:

a. *Indemnification not foreclosed by final judgment or other action on the merits.* Article 2.01—2 expressly provides that the issue of eligibility for indemnification is not foreclosed by a judgment or order against the defendant, by the settlement of the case by the defendant, by his conviction, or by a plea of *nolo contendere*. The statute states that such a determination "is not of itself determinative that the person did not meet the requirements" for discretionary indemnification.<sup>36</sup> In other words, even if a defendant settles or liability is judicially imposed on the merits, he may still seek to establish that he is entitled to indemnification on the basis of the substantive standards described above. This provision is not as startling as it may first appear since its primary impact is on settlements. Many settlements involve only a nominal payment, and it seems clear that the issue of eligibility should not thereby be foreclosed. In other situations, such as a criminal conviction, or a final judgment on the merits in a case involving disputed claims of breach of fiduciary duty, the conviction or judgment will probably foreclose indemnification as a practical matter. Theoretically the issue of eligibility is not foreclosed by the judgment, but the likelihood that the director may persuade finders of fact that he meets the standard for indemnification in the face of the judgment or conviction is slight. This provision does not create a presumption based on the substantive determination, but merely leaves open the possibility that the director may be able to establish eligibility for indemnification under article 2.02—1, section A, despite a judgment or conviction.<sup>37</sup>

b. *Indemnification of amounts paid in settlement or to satisfy judgments.* Indemnification under the old Texas statute was generally limited to expenses, including attorneys' fees.<sup>38</sup> Under article 2.02—1, the scope of per-

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34. *Id.* § F(3).

35. *Id.*

36. *Id.* § D.

37. *See id.* § A.

38. The prior statute permitted indemnification only of expenses actually and necessar-



missible indemnification is considerably broader. A person who meets the standards of article 2.02—1, section B, for permissive indemnification may be indemnified against “judgments, penalties (including excise and similar taxes), fines, settlements, and reasonable expenses actually incurred by the person in connection with the proceeding.”<sup>39</sup> If the suit is brought by or in the name of the corporation, however, indemnification is limited to expenses.<sup>40</sup> Otherwise, an obvious circularity would result.

*c. Obligations relating to employee pension plans.* Included within the scope of indemnification are “penalties (including excise and similar taxes) [and] fines.”<sup>41</sup> This article, along with article 2.02—1, section T, also addresses problems of directoral liability arising under the Federal Employees’ Retirement Income Security Act (ERISA).<sup>42</sup> The first sentence of section T states that the corporation is deemed to have requested a director to serve an employee benefit plan “whenever the performance by him of his duties to the corporation also imposes duties on or otherwise involves services by him to the plan or to the participants of the plan.”<sup>43</sup> This rather elliptical definition assures that a director who is serving as fiduciary of an employee benefit plan is nevertheless viewed as acting as a director for purposes of article 2.02—1. Special treatment was deemed necessary because of the broad definition of “fiduciary” in section 3(21) of ERISA<sup>44</sup> and the requirement of section 404<sup>45</sup> that a “fiduciary” must discharge his duties “solely in the interest” of the participants and beneficiaries of the employee benefit plan. The indemnification statute also states that the excise taxes assessed against a director under ERISA are classified as “fines” for purposes of indemnification, and that actions taken or omitted by a director with respect to an employee benefit plan “for a purpose reasonably believed by him to be in the interest of the participants and beneficiaries of the plan is deemed to be for a purpose which is not opposed to the best interest of the corporation.”<sup>46</sup> These specialized definitions permit the indemnification, on a discretionary basis, of ERISA liabilities if the director can establish that he acted for a “purpose reasonably believed by him to be in the interest of the participants and beneficiaries of the plan.”

*d. “Authorization” of indemnification and “determination” of indemnification.* The Texas statute, following section 5 of the Model Business Cor-

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ily incurred by a person in connection with the defense of any action, suit, or proceeding. See *id.* art. 2.02, § A(16) (Vernon 1980) (amended 1983).

39. *Id.* art. 2.02—1, § E (Vernon Supp. 1984).

40. *Id.*

41. *Id.*

42. Pub. L. No. 93-406, 88 Stat. 829 (1974) (codified in various sections of 5 U.S.C., 26 U.S.C., 29 U.S.C., 31 U.S.C., & 42 U.S.C.).

43. TEX. BUS. CORP. ACT ANN. art. 2.02—1, § T (Vernon Supp. 1984).

44. 29 U.S.C. § 1002(21) (1976).

45. *Id.* § 1104(a)(1) (1976 & Supp. V 1981).

46. TEX. BUS. CORP. ACT ANN. art. 2.02—1, § T (Vernon Supp. 1984).

poration Act, distinguishes between "authorization" of indemnification and "determination" of indemnification.<sup>47</sup> The basic idea is that the decision that a director is eligible for discretionary indemnification is quite different from the decision that the corporation should expand its limited assets in making a discretionary indemnification. The latter is described as an "authorization" to indemnify to distinguish it from the "determination" that the director is eligible for indemnification. Generally, "determinations" and "authorizations" are placed in the same hands, such as the uninvolved directors or a committee of at least two uninvolved directors. In the case of a "determination" that a director is eligible for indemnification by a special legal counsel, however, the draftsmen did not believe it to be appropriate to place in his hands the "authorization" issue, which involves the most effective use of corporate resources as between indemnification and other corporate purposes.<sup>48</sup> In the event special legal counsel determines that indemnification is appropriate, "authorization" should be by the groups entitled to name the special legal counsel.<sup>49</sup> Thus, the "authorization" may be made by the entire board, including the directors who are involved as defendants in the proceeding.

*e. Application of "reasonableness" requirements.* The old Texas statute, following the 1950 version of the Model Business Corporation Act, permitted indemnification only of "expenses actually and necessarily incurred."<sup>50</sup> More recent statutes permit indemnification of "expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred."<sup>51</sup> The Texas statute adopted in 1983 distinguishes between expenses on the one hand and indemnification of other items on the other, and imposes a reasonableness requirement only on the former.<sup>52</sup> A reasonableness requirement is clearly appropriate for expenses, but is arguably less appropriate for determining indemnification of judgments or fines (to the extent they are eligible for indemnification at all) since these amounts are set by courts. Amounts paid in settlement are more analogous to judgments or fines than to expenses in this regard, and it seems undesirable to require the board or a committee to make a judgment that a settlement is "reasonable" as a condition for authorizing indemnification.

The persons or groups that make determinations to "authorize" indemnification also determine the reasonableness of expenses under the Texas statute.<sup>53</sup> As a result, special legal counsel, called upon to make the difficult ethical judgments required to establish eligibility for discretionary indemnification, is not expected to pass on the question of whether certain expenses incurred were reasonable in amount. This decision, like the deci-

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47. *Id.* § G.

48. *Id.*

49. *Id.*; see *supra* note 35 and accompanying text.

50. TEX. BUS. CORP. ACT ANN. art. 2.02, § A(16) (Vernon 1980) (amended 1983).

51. MODEL BUS. CORP. ACT § 5(b) (1979) (emphasis added).

52. TEX. BUS. CORP. ACT ANN. art. 2.02—1, §§ H, K (Vernon Supp. 1984).

53. *Id.* § G.

sion to utilize corporate assets for discretionary indemnification, was viewed essentially as a corporate policy decision rather than an ethical decision.

*f. What is a proceeding?* Article 2.02—1, section A(5), defines “proceeding” to include a variety of nontraditional proceedings, such as administrative, investigative, or arbitral, as appropriate subjects for indemnification.<sup>54</sup> The statute also includes appeals in all such actions and “any inquiry or investigation that could lead to such an action, suit, or proceeding.”<sup>55</sup> This broad and somewhat circular definition was designed to resolve by statute questions that had arisen under earlier provisions referring only to “actions, suits, or proceedings,” or words of similar import. The Texas statute now clearly permits, for example, the indemnification of the expenses of a director who is called as a witness in a grand jury proceeding; it was unclear under earlier statutes whether such indemnification was permitted.

*g. Indemnification of officers and employees.* The indemnification of officers or agents of a corporation is often required by contract as part of the agreed-upon compensation of the officer or agent. General principles of agency law may also authorize indemnification. Under most statutes the relationship between these nonstatutory rights of indemnification and the statutory right of indemnification is unclear where an officer or agent is also a director. Following the substance, though not the language, of the Model Act provision, the new Texas Business Corporation Act provisions<sup>56</sup> carefully define the relationship between the statutory and nonstatutory rights of indemnification:

(i) The nonstatutory rights of indemnification of officers, employees, or agents who are not directors are fully preserved.<sup>57</sup>

(ii) An officer, employee, or agent of the corporation may also be indemnified to the same extent as a director may be indemnified under the new statute.<sup>58</sup> This right of indemnification also extends to officers, employees, or agents who are serving, or who at one time served, “as nominees and designees” as a director, officer, or partner.<sup>59</sup>

(iii) An officer who is also a director is limited to the indemnification rights of a director under the statute.<sup>60</sup> This assures that inside and outside directors receive identical treatment with respect to indemnification.

(iv) “Nominees” or “designees” of the corporation serving at the corporation’s request in another corporation, partnership, joint venture, proprietorship, trust, employee benefit plan, or other enterprise may be

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54. TEX. BUS. CORP. ACT ANN. art. 2.02—1, § A(5) (Vernon Supp. 1984).

55. *Id.*

56. *See id.* §§ O, Q.

57. *Id.* § Q.

58. *Id.* §§ O, P.

59. *Id.* § Q.

60. *Id.* § O.

indemnified to the same extent as a director under the statute even though these "nominees" or "designees" were not officers or employees of the corporation.<sup>61</sup> The Model Act does not contain a counterpart to this broad provision.

*h. Advancement of funds for expenses.* Another important innovation of the Model Act that is followed in the new Texas indemnification statute relates to advancement of funds for indemnification at the outset of the proceeding, long before its eventual outcome can be predicted.<sup>62</sup> Practical experience with indemnification made it clear that indemnification before final resolution of the litigation was often critical if the ends of the indemnification statute were to be met. Many directors were unable or unwilling to advance personal funds to cover the very substantial costs of retaining counsel and setting up a defense. Yet expert assistance at this stage may well be essential if an effective defense is to be developed. Further, unless advance indemnification is permitted, an undesirable distinction is drawn between directors with large financial resources who could invest funds in an adequate defense and those without such resources, who could not.

On the other hand, it is difficult to reconcile the various restrictions on discretionary indemnification, which depend on the outcome of the litigation, with advance payments made at the commencement of litigation, long before there has been any decision on the merits of the litigation. The only Texas case dealing with indemnification concluded that advance payments were not authorized by the Texas statute.<sup>63</sup> Resolution of this problem was a major justification for adoption of a new indemnification statute.

The Model Act solution, developed as a "reasonable compromise,"<sup>64</sup> was faithfully followed in the Texas statute.<sup>65</sup> Basically, a director may be granted advances on indemnification if the director makes an affirmation that he believes in good faith that he is entitled to indemnification and submits a written "undertaking" to repay the amount advanced if it is ultimately determined that he is not entitled to indemnification.<sup>66</sup> The undertaking, however, need not be secured and may be accepted without reference to the financial ability of the director to make repayment. This provision is justified on the ground that it avoids discrimination between directors with ample financial resources and those without. A security requirement would tend to limit advance indemnification to directors who already had sufficient resources to finance their initial defense.

The major limitation on the power to make advances on indemnification

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61. *Id.* § P.

62. *See id.* § K.

63. *See* Texas Soc'y, Daughters of the Am. Revolution, Inc. v. Fort Bend Chapter, The Nat'l Soc'y, Daughters of the Am. Revolution, Inc., 590 S.W.2d 156, 159 (Tex. Civ. App.—Texarkana 1979, writ ref'd n.r.e.). This case actually arose under the Texas Nonprofit Corporation Act, although the statutory language is identical.

64. *See Indemnification of Corporate Personnel, supra* note 6, at 115.

65. TEX. BUS. CORP. ACT ANN. art. 2.02—1, §§ K, L (Vernon Supp. 1984).

66. *Id.* § L.

is the requirement that when a payment is authorized those making the determination to indemnify must conclude "that the facts then known" would not preclude indemnification under the statute.<sup>67</sup> This provision attempts to steer a middle ground between requiring a full scale investigation or review of the merits of the defendant's position before each advance is made and permitting those making the determination to "bury their heads in the sand" and authorize advances even though the director's defense stands little or no chance of succeeding and indemnification will ultimately be denied.

Determinations to make advances of indemnification are to be made by the same persons, on grounds, and in the same manner, as determinations of discretionary indemnification: by disinterested directors, a committee of disinterested directors, disinterested shareholders, or special legal counsel.<sup>68</sup>

*i. Insurance.* The new Texas indemnification statute retains the express power appearing in the previous statute that authorizes the corporation to purchase directors' and officers' liability insurance.<sup>69</sup> The insurance may cover all the various liabilities that are covered by the new statute (e.g., liabilities incurred when serving as a trustee of an employee benefit plan), and in addition may insure against liabilities "whether or not the corporation would have the power to indemnify him against that liability under this article."<sup>70</sup> The scope of this last clause is justified on the ground that insurance coverage is limited only to "insurable events," so that there is built-in protection against coverage that may involve violations of public policy.

*j. Reporting of indemnification to shareholders.* In the course of the development of the Model Act provision on indemnification, the draftsmen made an effort to meet the most serious criticisms directed by academic commentary toward earlier versions of the indemnification provision. One complaint was that the statutes permitted directors or "special legal counsel" to authorize indemnification in relative secrecy without every advising shareholders that corporate funds were being used for this purpose.<sup>71</sup> The Texas statute follows the Model Act in requiring that shareholders be given notice of all such payments,<sup>72</sup> but improves upon the analogous language of the Model Act by specifying precisely when the notice must be given, and assuring that notice in all events will be given within twelve months of the time of indemnification.<sup>73</sup> The Model Act simply provided

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67. *Id.* § K(2).

68. *Id.* § L; see *supra* notes 29-35 and accompanying text.

69. TEX. BUS. CORP. ACT ANN. art. 2.02—1, § R (Vernon Supp. 1984); see *id.* art. 2.01, § A(16) (Vernon 1980) (amended 1983).

70. TEX. BUS. CORP. ACT ANN. art. 2.02—1, § R (Vernon Supp. 1984).

71. See Bishop, *Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers*, 77 YALE L.J. 1978, 1979-80 (1968).

72. TEX. BUS. CORP. ACT ANN. art. 2.02—1, § S (Vernon Supp. 1984).

73. The Texas statute requires this notice "with or before the notice or waiver of notice

that notice be given "with or before the notice of the next shareholders' meeting."<sup>74</sup>

*k. Exclusivity of the statutory indemnification provision.* In the skeletal indemnification provision in the earlier Texas statute, many attorneys took solace in the provision that the statutory right was not exclusive,<sup>75</sup> and included elaborate provisions in articles of incorporation or bylaws that often closely followed the Delaware indemnification statute. Because the new statute attempts to define precisely the permissible outer limits of indemnification, there is no analogous provision in the new statute. To the contrary, article 2.02—1, section M states that

[a] provision for a corporation to indemnify or to advance expenses to a director . . . whether contained in the articles of incorporation, the bylaws, a resolution of shareholders or directors, an agreement, or otherwise . . . is void unless it is consistent with this article as limited by the articles of incorporation, if such a limitation exists.<sup>76</sup>

A comment to the analogous Model Act provision notes that this language is

not intended to preclude charter, by-law, or contract arrangements designed to provide procedural machinery that is not inconsistent with the statute or to make the permissive provisions of [the statute] mandatory if and when the occasion for indemnification arises. For example, a corporation may properly obligate the board to consider and act expeditiously on an application for indemnification or advances, or obligate the board to cooperate in the procedural steps required to obtain a judicial determination . . . or both.

Some corporations currently commit themselves, in one form or another, to indemnify directors to the fullest extent permitted by applicable law. The Committee believes that such commitments are valid . . . subject to appropriate interpretation in light of the facts and circumstances of the particular case.<sup>77</sup>

Presumably the Texas statute will be given the same interpretation.

*l. Restriction on the right of indemnification.* Most corporations want to provide the broadest possible indemnification in order to encourage persons to agree to serve on the board of directors. Some corporations, however, may wish to restrict the right of indemnification because of internal control concerns between competing factions or because of concern over the financial position of the corporation. The power to restrict the right of indemnification by appropriate provisions in the articles of incorporation is specifically recognized for discretionary or mandatory indemnification,

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of the next shareholders' meeting or with or before the next submission to shareholders of a consent to action without a meeting" and in any case, within 12 months. *Id.*

74. MODEL BUS. CORP. ACT § 5(K) (1981).

75. See TEX. BUS. CORP. ACT ANN. art. 2.02, § A(16) (Vernon 1980) (repealed 1983).

76. *Id.* art. 2.02—1, § M (Vernon Supp. 1984).

77. *Indemnification of Corporate Personnel*, *supra* note 6, at 116.

for court-ordered indemnification, and for advances for expenses.<sup>78</sup>

### B. Dividend Restrictions

In 1983 the Texas Legislature made a number of important changes in the statutory restrictions on the making of distributions, including dividends and the redemption of shares.<sup>79</sup> The draftsmen were largely concerned with simplifying the problems of attorneys and accountants when faced with the need to advise clients, particularly corporations with wholly or partially owned subsidiaries, regarding the determination of the amount of surplus available for dividends and share repurchases. A literal application of the former statutes subjected corporations with subsidiaries to the expense of preparing special financial statements for each entity that often did not conform with generally accepted accounting principles or with other statements prepared by the corporation.<sup>80</sup> The changes made, however, go far beyond this modest purpose.

1. *Safe harbor for determining validity of distributions.* Article 2.17 of the Act was amended by the addition of a new section E, designed to protect directors who declare dividends or authorize other distributions on the basis of routinely available financial records of the corporation.<sup>81</sup> Paragraph (1) of section E provides that the

[d]etermination of net assets and the surplus of a corporation, and each of their components, may be based on

(a) financial statements [prepared] in accordance with generally accepted accounting principles [(GAAP)];

(b) financial statements prepared on the basis of the accounting used to prepare the corporation's federal income tax return or any other accounting practices and principles that are reasonable in the circumstances;

(c) financial information . . . that is prepared on a basis consistent with [GAAP statements or with the accounting principles used to prepare the corporation's tax returns];

(d) a fair valuation or any other method that is reasonable in the circumstances; or

(e) any combination of such statements or information authorized

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78. TEX. BUS. CORP. ACT. ANN. art. 2.02—1, § U (Vernon Supp. 1984). The Model Act scatters clauses authorizing the articles to limit the right of indemnification throughout the various sections. The Texas statute sensibly groups the clauses in a single paragraph at the end of the section.

79. *See id.* art. 2.17, §§ E-F (Vernon Supp. 1984).

80. The Act proceeded on the assumption that each corporation was a separate entity. Thus, a corporation is arguably acting improperly if it considers the earned surplus of even a wholly owned subsidiary as available for distribution, unless an internal dividend is first paid to the parent by the subsidiary. On the other hand, generally accepted accounting principles mandate that the financial position and cash flow of a corporation and its subsidiaries be consolidated for reporting purposes because consolidation is deemed more meaningful than separate reporting.

81. TEX. BUS. CORP. ACT ANN. art. 2.17, § E (Vernon Supp. 1984).

by this section.<sup>82</sup>

There appears to be the beginning of a trend toward the elimination of financial restrictions that provide no meaningful protection for creditors<sup>83</sup> and the creation of significant protection for directors, particularly directors of large publicly held corporations, when they rely on information provided them by corporate officers in the normal course of their duties.<sup>84</sup> The Texas amendments are broadly consistent with these trends, and there can be little objection to the motives behind these sections. There are, nevertheless, practical problems with the method adopted by the draftsmen of the Texas Business Corporation Act; the draftsmen of the Model Act refused to accept provisions similar to those included in the Texas statute despite the repeated urging by some of the same individuals who were instrumental in the preparation of the revisions in the Texas statute. The basic problem is that the "safe harbor" provided by article 2.17 is not a self-contained statutory provision. It refers either to GAAP principles or to the accounting principles followed in the preparation of the corporation's federal income tax return.<sup>85</sup> The principles referred to in both instances are vague to some extent. For example, there is not complete agreement as to precisely which principles are GAAP and which are not. Further, GAAP principles are themselves the product of a continuing review by various accounting bodies, so that the Texas statute now refers to a changing set of principles prepared by national bodies of accountants. Statutory incorporation by reference of standards that are subject to change from time to time by outside groups have traditionally been viewed with suspicion as involving standardless delegation of legislative authority.<sup>86</sup>

2. *Determination of the time at which the validity of distributions are to be measured.* A problem that has troubled corporate attorneys dealing with the largely arbitrary traditional restrictions on the making of dividends

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82. *Id.* § E(1)(a)-(d). Illustrative of the care with which these provisions were drafted is the following clause: "including without limitation financial statements that include subsidiary corporations or other corporations accounted for on a consolidated basis or on the equity method of accounting." *Id.* § E(1)(a). These provisions deal only with the issue of directoral liability under the Texas Business Corporation Act and are inapplicable to the calculation of the Texas franchise tax or other state taxes imposed on corporations. *Id.* § E(2). This limitation provision was apparently added late in the legislative process at the request of the comptroller's office.

83. The Model Act, for example, dramatically simplified statutorily mandated financial accounting provisions by eliminating the concepts of par value, stated capital, earned or capital surplus, and treasury shares. See Committee on Corporate Laws, *Changes in the Model Business Corporation Act—Amendments to Financial Provisions*, 35 BUS. LAW. 1365 (1980) (adopting changes proposed in Committee on Corporate Laws, *Changes in the Model Business Corporation Act—Amendments to Financial Provisions*, 34 BUS. LAW. 1867 (1979)).

84. The Model Act contains broad provisions protecting directors who rely on such information. See MODEL BUS. CORP. ACT § 35 (1979).

85. TEX. BUS. CORP. ACT ANN. art. 2.17, § E (Vernon Supp. 1984).

86. See 73 AM. JUR. 2D *Statutes* §§ 28-29 (1974). Problems may also be raised if directors rely on financial statements that were prepared in accordance with principles that were GAAP at an earlier time, but have been superseded or questioned thereafter.



and distributions is the time at which the measurements are to be made.<sup>87</sup> The problem is particularly acute in connection with the repurchase or redemption of shares for promissory notes under article 2.03 of the Texas Business Corporation Act, because the article was not clear as to whether the insolvency and earned surplus limitations were to be applied only at the time the shares were reacquired and the promissory notes issued, or whether one or both tests were to be separately applied to each payment on each promissory note. This issue was the subject of the Texas Supreme Court's decision in *Williams v. Nevelow*<sup>88</sup> and the subject of an amendment to article 2.03, section F in 1973,<sup>89</sup> which was questionably construed by the Texas Supreme Court in dictum in *Williams*.<sup>90</sup> Without waiting for a definitive construction of the post-1973 amendments, the Texas Legislature again addressed this issue in 1983 in language that appears to leave no future uncertainty: "For the purposes of this section, payment for shares acquired in consideration of any indebtedness or deferred payment obligation of the corporation is deemed to have been made on the date the indebtedness or obligation is incurred."<sup>91</sup> The result is that the restrictions against distributions of assets by corporations apply only at the time of the original transaction in which the shares were returned to the corporation. This provision follows a similar section of the 1980 amendments to the Model Business Corporation Act<sup>92</sup> and is based on a weighing of conflicting arguments: on the one hand, a promissory note reflecting the repurchase of shares is similar to a promise to pay future dividends, and it is not clear why payments on such a note should not also be viewed as dividends. On the other hand, the corporation could have paid out cash to the shareholder (since the earned surplus and insolvency standards were met at the time of the original transaction) and the creditors should not be better off if a note rather than cash is distributed. The draftsmen accepted this latter argument, suggesting that the protection provided by the fiduciary duty standards of directors of a corporation and remedies with respect to creditors' fraud would adequately safeguard any abuse of the intent of this provision.

To avoid uncertainty as to whether the earned surplus restrictions are applicable at the time of declaration or the time of payment of a dividend or other distribution when there is a significant delay between the two dates, article 2.17, section F provides definite rules for determining when

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87. See Herwitz, *Installment Repurchase of Stock: Surplus Limitations*, 79 HARV. L. REV. 303, 313-19 (1965).

88. 513 S.W.2d 535 (Tex. 1974). The 1983 amendment essentially codifies the rule of this case.

89. In 1973 the legislature added the phrase "or make payment, directly or indirectly" to the word "purchase" in TEX. BUS. CORP. ACT ANN. art. 2.03, § F (Vernon 1980) (insolvency restriction). Apparently, the intent was to apply the insolvency test but not the earned surplus test to each payment.

90. See 513 S.W.2d at 538-39.

91. TEX. BUS. CORP. ACT ANN. art. 2.17, § F (Vernon Supp. 1984).

92. MODEL BUS. CORP. ACT § 45 (1980 amendment); see Committee on Corporate Laws, *Changes in the Model Business Corporation Act—Amendments to Financial Provisions*, 34 BUS. LAW. 1867, 1872 (1979).

the restrictions are to be applied: if the payment occurs within 120 days of the declaration, earned surplus is to be measured at the time of the declaration, but if payment is delayed by more than 120 days, earned surplus is to be measured as of the date of payment.<sup>93</sup> This provision, however, does not affect the rule of article 2.03, section F, which treats the repurchase of shares for debt as occurring when the shares are repurchased and the debt issued.<sup>94</sup> The legislative history of this provision contains a useful chart setting forth how this provision would operate in practice.<sup>95</sup>

The legislature also made conforming changes in article 2.41 of the Texas Business Corporation Act, which imposes liability on directors for

93. TEX. BUS. CORP. ACT ANN. art. 2.17, § F (Vernon Supp. 1984).

94. *Id.* art. 2.03, § F.

95. The following are examples of how corporate repurchase and dividends may be affected by the proposed amendments:

	Jan. 1	Mar. 1	May 1	July 1	Resolution
Art. 2.41, § A					
1. Corporation declares cash dividend	Directors approve; corporation is solvent; earned surplus is adequate	Corporation becomes insolvent; earned surplus not adequate		Dividend is paid	Directors exonerated under art. 2.41, § A; corporation violates art. 2.38
2. Corporation repurchases shares for cash	Directors approve; corporation is solvent; earned surplus is adequate	Corporation becomes insolvent; earned surplus not adequate		Repurchase for cash	Directors exonerated under art. 2.41, § A; corporation violates art. 2.03
3. Corporation repurchases shares for debt (a note)	Directors approve; corporation is solvent; earned surplus is adequate	Corporation becomes insolvent; earned surplus not adequate	Note issued on Apr. 30 (before expiration of 120 days)		Directors exonerated under art. 2.41, § A; no violation of surplus provisions by corporation under art. 2.17, § F; violation of insolvency provisions of art. 2.03, § F by corporation

making illegal dividends.<sup>96</sup> The legislative history indicates that this change was adopted as a "further positive factor for Texas in determining which state is most advantageous in which to incorporate."<sup>97</sup> In article 2.41 the act giving rise to liability is defined with precision as voting or assenting to a dividend or distribution that, "on the date of that vote or assent," violates a provision of the Act.<sup>98</sup>

The legislature also revised article 2.41, section C, primarily to conform

	<i>120 days</i>				Resolution
	Jan. 1	Mar. 1	May 1	July 1	
Art. 2.03, § F					
Corporation repurchases shares for debt (a note)	Corporation is insolvent; directors approve repurchase, issue note; date of note is date of purchase				Violates art. 2.03, § F
Art. 2.17, § F					
1. Corporation repurchases shares for cash	Directors approve; earned surplus adequate	Earned surplus not adequate		Repurchase for cash	Violates art. 2.03.
2. Corporation repurchases shares for debt (a note)	Directors approve; earned surplus adequate	Earned surplus not adequate		Note is issued	Violates art. 2.03.
3. Corporation repurchases shares for cash	Directors approve; earned surplus adequate	Earned surplus not adequate	Repurchase for cash on April 30 (before expiration of 120 days)		No violations of art. 2.03; surplus adequate at Jan. 1
4. Corporation repurchases shares for debt (a note)	Directors approve; earned surplus adequate	Earned surplus not adequate	Note is issued on Apr. 30 (before expiration of 120 days)		No violation of art. 2.03; surplus adequate at Jan. 1
5. Corporation declares cash dividend	Directors approve; earned surplus adequate	Earned surplus not adequate	Dividend paid on Apr. 30 (before expiration of 120 days)		No violation of art. 2.38

Memorandum from Marc H. Folladori to Gary A. Herman, "Miscellaneous Amendments to the Texas Business Corporation Act ('TBCA') and the Texas Miscellaneous Corporation Laws Act," app. (Feb. 28, 1983) (analysis of proposed miscellaneous amendments to Texas corporate statutes) [hereinafter cited as Folladori Memorandum].

96. TEX. BUS. CORP. ACT ANN. art. 2.41 (Vernon Supp. 1984).

97. Folladori Memorandum, *supra* note 95.

98. TEX. BUS. CORP. ACT ANN. art. 2.41, § A(1) (Vernon Supp. 1984).

the language to current financial usage. Reliance by directors is protected if they rely in good faith upon financial statements "or other information" that are represented to them to be correct "in all material respects" by an appropriate corporate officer or "reported" by an independent public or certified public accountant to "present fairly" the financial "position" of the corporation.<sup>99</sup> The words in quotation marks were added or amended by the 1983 amendments. The legislative history notes that remedies for fraud, breach of fiduciary standards, and failure to meet the standards of the business judgment rule could ensnare a director despite this article.

3. *Loans to officers or directors.* The statutory restrictions on loans to officers or directors have long been recognized as unduly restrictive; the 1950 Model Act provisions from which they were drawn were long ago amended.<sup>100</sup> The 1983 amendments in Texas finally removed these anachronisms. Article 2.02, section A(6), the general powers article of the Act, was amended to permit loans to officers or directors "if such a loan or assistance reasonably may be expected to benefit, directly or indirectly, the lending or assisting corporation."<sup>101</sup>

If a corporation may generally make loans to its officers or directors when there is a reasonable belief that the corporation will benefit thereby, a corporation should certainly be able to guarantee the repayment of a loan made to an officer or director if the corporation reasonably believes that the guaranty will benefit the corporation. As a result of the changes made in article 2.02 of the Act, article 2.06 of the Texas Miscellaneous Corporation Laws Act was broadened to authorize corporate guarantees as well as direct loans to officers and directors.<sup>102</sup> A memorandum prepared by the bar committee described this change as providing an additional factor in Texas's favor with respect to choices of states in which to incorporate or reincorporate. According to the committee,

[c]ertainly a jurisdiction which permits this kind of assistance to key employees and policy-makers of a corporation would aid that corporation in obtaining and retaining important personnel. For instance, this amendment would enable a Texas corporate employer to guarantee an officer's mortgage note on his new house which he purchased upon his transfer to his new locale as required by his employer. Indirectly, this could also result in additional talented and financially capable individuals relocating in Texas, which would assist our state both financially and otherwise.<sup>103</sup>

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99. *Id.* § C.

100. Section 43(e) of the 1960 Model Act was amended in 1969 to eliminate these restrictions when the section was recodified as section 48 of the 1969 Model Act. *See* 2 MODEL BUS. CORP. ACT ANN. 4 (2d ed. 1969).

101. TEX. BUS. CORP. ACT ANN. art. 2.02, § A(6) (Vernon Supp. 1984). The clause previously authorized assistance or loans to employees, but excluded officers and directors. A conforming change was also made in art. 2.41, § A(4). *See id.* art. 2.41, § A(4) (Vernon Supp. 1984).

102. *See* TEX. REV. CIV. STAT. ANN. art. 1302—2.06, § B (Vernon Supp. 1984).

103. Follodori Memorandum, *supra* note 95.

4. *Loans secured by shares of the corporation.* Another anachronistic provision in the Texas Business Corporation Act prohibited loans "secured by shares of the corporation."<sup>104</sup> The concern underlying this prohibition was apparently that directors might not realize that shares of the corporation are not assets when acquired by the corporation. The Model Act provision from which this was taken<sup>105</sup> has long since been repealed. The corresponding language was eliminated from the Texas statute in 1983.<sup>106</sup>

5. *Board vacancies.* The Act has long retained a distinction between vacancies on the board of directors (that are to be filled only by the balance of the board) and newly created directorships (that are to be filled only by the shareholders).<sup>107</sup> This dichotomy is unrealistic on at least two levels: no inherent reason exists why the board, in appropriate cases, should not fill newly created directorships as well as vacancies; similarly, no inherent reason exists why vacancies created by death or resignation should not be filled by the shareholders if that is otherwise convenient. In the 1983 amendments both of these anomalies were corrected.<sup>108</sup> Because of possible abuse by the board of a power to create new directorships and then fill them without shareholder action, the power of the board to fill newly created directorships was limited in two respects: the person named by the board to fill such a directorship can continue only "until the next election of one or more directors" and the board "may not fill more than two such directorships during the period between any two successive annual meetings of shareholders."<sup>109</sup> These limitations appear reasonable since they would not hamper the board in the normal case in which a board wishes to add a new director; the board may create a new directorship and fill it. Doubtless almost all such situations involve entirely proper motives. The legislative history of this provision states that it was included to

afford additional flexibility for directors in conducting their corporation's affairs. For instance, often when a corporation acquires another corporation by merger, consolidation, purchase of shares, or purchase of assets the acquiring corporation desires representation on its board by representative[s] of the acquired corporation. This is desired because of the input these new representatives can offer by their knowledge and experience with respect to the acquired corporation's business. Presently, in order to increase the number of positions on the board to accommodate the acquired corporation's representatives, a shareholders' meeting must be called.<sup>110</sup>

Because of the newly created power in the board to fill newly created di-

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104. TEX. BUS. CORP. ACT ANN. art. 2.41, § A(4) (Vernon 1980) (amended 1983).

105. MODEL BUS. CORP. ACT § 43(d) (1960).

106. See TEX. BUS. CORP. ACT ANN. art. 2.41, § A(4) (Vernon Supp. 1984).

107. *Id.* art. 2.34.

108. See *id.* art. 2.34, § B.

109. *Id.* This last clause, in particular, has the earmarks of a compromise. The legislative history indicates that the number was chosen by analogy to similar provisions in the Texas banking laws rather than through a formula of some type.

110. Folladori Memorandum, *supra* note 95.

rectorships to a limited extent, a conforming change was made in article 2.36 to prohibit an executive committee from exercising this power.<sup>111</sup> This restriction was felt to be appropriate because the Act prohibits an executive committee from filling vacancies on the board.

6. *Financial transactions by foreign corporations.* Article 8.01 of the Act contains a "laundry list" of factors that do not constitute the transaction of business within Texas for purposes of qualifying to transact business in the state.<sup>112</sup> In 1983 the legislature amended this list in a minor respect to make it clear that neither a borrower nor a lender transacts business in Texas merely by creating or acquiring indebtedness or mortgages or other security interests in real or personal property. Prior to this amendment, the language expressly covered only the creation of indebtedness.<sup>113</sup>

7. *Uncertificated securities.* In 1983 Texas adopted uniform amendments to its version of the Uniform Commercial Code to provide for certificateless securities.<sup>114</sup> In this respect, Texas joins a growing list of states that have adopted these amendments, which were first proposed in 1978.<sup>115</sup> Uncertificated securities have long been used by limited classes of issuers, particularly mutual funds and more recently by money market funds. The genesis of the proposal to make specific provision for certificateless securities for all corporations was the so-called "back office crunch" of the late 1960s, when brokerage firm administrative offices proved unable to keep up with the avalanche of certificates arising from trading in the range of ten to twenty million shares per day. Although these problems have been solved largely through the use of computerization of records and central depository corporations,<sup>116</sup> certificates generally were viewed as a clumsy device to record trading and share ownership. As a result, interest in the certificateless security approach has continued despite the solution of the "back office" problem that gave rise to the original inquiry. Under the new amendments uncertificated securities will probably become widely used by closely held as well as publicly held corporations.

Chapter 8 of the Texas Business and Commerce Code consists of article 8 of the Uniform Commercial Code, which sets forth a comprehensive statute for certificated securities.<sup>117</sup> This pattern has been left almost entirely unaffected; the new treatment of uncertificated securities closely parallels the existing treatment of certificated ones.<sup>118</sup> The most obvious

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111. TEX. BUS. CORP. ACT ANN. art. 2.36 (Vernon Supp. 1984).

112. *Id.* art. 8.01, § B.

113. *Id.* art. 8.01, § B(7) (Vernon 1980).

114. Texas Business & Commerce Code, ch. 442, 1983 Tex. Gen. Laws 2511.

115. By the end of 1982 these amendments had been adopted in Colorado, Connecticut, Maine, Minnesota, New York, and West Virginia. See 2A U.L.A. 175 (Supp. 1983).

116. A central depository immobilizes certificates in the hands of the depository and permits trading based on book entries in the depository corporation records.

117. TEX. BUS. & COM. CODE ANN. §§ 8.101-.406 (Tex. UCC) (Vernon 1980 & Supp. 1984).

118. See generally Special Project, *Uncertificated Securities, Articles 8 and 9 of the U.C.C., and the Texas Business Corporation Act: A New System to Accommodate Modern Securities*

difference between certificated and uncertificated securities is that the certificate, which traditionally conveys information and supplies essential and often binding evidence of ownership, does not exist. Rather, the issuer of uncertificated securities keeps a record of the registered owner, of one pledgee (if any), and of certain third party claims to the security.<sup>119</sup> The issuer treats the registered owner as the party entitled to vote, receive notices, and exercise other shareholder rights.<sup>120</sup>

If the registered owner wishes to transfer an uncertificated security through registration, he issues an "instruction" to the issuer to make the transfer.<sup>121</sup> If the various requirements are met, the issuer must register the transfer,<sup>122</sup> and the transfer is effective when it is registered on the issuer's books.<sup>123</sup> Within two business days after the transfer has been registered, the issuer sends the new registered owner an "initial transaction statement" that describes the security and notes certain liens thereon.<sup>124</sup> The issuer must furnish similar statements at least annually or upon the written request of the registered owner.<sup>125</sup> The initial transaction statement serves as a substitute for the certificate to a limited extent, but it serves only as a record of the interest and does not represent the interest. It is not received in all cases.

8. *Fraud in securities and land transactions.* In 1983 section 27.01 of the Texas Business and Commerce Code, the old section of the Texas statutes dealing with fraud in land and securities transactions, was amended in both substantive and damage-measurement respects.<sup>126</sup> The basic definitions of "false representation" and "false promise" were not amended,<sup>127</sup> but the consequences of making such a representation or promise were amended as follows: (1) a person who makes a false representation or false promise is liable to the person defrauded for actual damages; (2) a person who makes a false representation or false promise with "actual awareness" of the falsity is liable, in addition, for exemplary damages; and (3) a person who benefits from a false representation or false promise commits fraud if he is actually aware of the falsity of the representation or promise and does not disclose it.<sup>128</sup> Under the literal language of section 27.01 before its amendment, a person who benefits from a false representation or false

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*Transactions*, 11 TEX. TECH L. REV. 813 (1980) (discussion of proposed 1983 amendments). For a discussion of the desirability of the pattern adopted for uncertificated securities in article 8, see Aronstein, Haydock & Scott, *Article 8 Is Ready*, 93 HARV. L. REV. 889 (1980); Coogan, *Security Interests in Investment Securities Under Revised Article 8 of the Uniform Commercial Code*, 92 HARV. L. REV. 1013 (1980).

119. TEX. BUS. & COM. CODE ANN. §§ 8.403(d), (g) (Tex. UCC) (Vernon Supp. 1984).

120. *Id.* § 8.207(b).

121. *Id.* §§ 8.207(d).

122. *Id.* § 8.401(a).

123. *Id.* § 8.313(a)(2).

124. *Id.* § 8.408(a).

125. *Id.* § 8.408(f).

126. Act of Sept. 1, 1983, ch. 949, 1983 Tex. Gen. Laws 5208.

127. See TEX. BUS. & COM. CODE ANN. § 27.01(a) (Vernon 1980).

128. *Id.* § 27.01(b)-(d) (Vernon Supp. 1984). "Actual awareness may be inferred where objective manifestations indicate that a person acted with actual awareness." *Id.* § 27.01(c).

promise was deemed to have committed fraud merely by accepting the benefit.<sup>129</sup>

The damage-measurement sections were amended by repeal of the old statutory measure of "actual damage," which limited recovery to the difference between the market value of the shares or land as represented and their actual value,<sup>130</sup> and by authorization of "exemplary damages" as well as actual damages without specification of the amount.<sup>131</sup> The old statute specified exemplary damages equal to twice the "actual damage."<sup>132</sup> Finally, a person liable under this section is now also liable for reasonable and necessary attorneys' fees, expert witness fees, costs for copies of depositions, and costs of court.<sup>133</sup> These various amendments are prospective only and do not affect liability on transactions entered into before September 1, 1983.<sup>134</sup>

9. *Venue.* In 1983 the legislature completely overhauled the Texas venue statute.<sup>135</sup> New section 3(f) dealing with corporations and associations modifies the old section by eliminating the option to bring suit in the county of which the corporation's "registered office" is located.<sup>136</sup> Suits may continue to be brought in the county in which the corporation's "principal office" is located.<sup>137</sup> One side effect of this change is that cases decided before the present survey period, holding that a foreign corporation may always be sued in the county in which its registered office is located, are no longer viable.<sup>138</sup>

10. *Miscellaneous amendments.* The Texas Legislature in 1983 also made a number of minor changes in technical requirements, fees, and similar matters.<sup>139</sup> While these changes do not justify discussion in an annual survey, at least a warning to practicing attorneys is appropriate: because of

129. *Id.* § 27.01(b) (Vernon 1980) (amended 1983).

130. *Id.* The last sentence of the statute provided that the "measure of actual damages is the difference between the value of the real estate or stock as represented or promised, and its actual value in the condition in which it is delivered at the time of the contract." *Id.*

131. *Id.* § 27.01(c) (Vernon Supp. 1984).

132. *Id.* § 27.01(a) (Vernon 1980) (amended 1983).

133. *Id.* § 27.01(e) (Vernon Supp. 1984).

134. Act of Sept. 1, 1983, ch. 949, § 2, 1983 Tex. Gen. Laws 5208, 5209.

135. See TEX. REV. CIV. STAT. ANN. art. 1995 (Vernon Pam. Supp. 1964-1983).

136. *Id.* § 3(f). As a result of this amendment, *Ward v. Fairway Operating Co.*, 364 S.W.2d 194, 195 (Tex. 1964), which held venue is proper both in the county of the corporation's registered office and the county of the corporation's principal office, is now obsolete.

137. TEX. REV. CIV. STAT. ANN. art. 1995 (Vernon Pam. Supp. 1964-1983).

138. *Joy Mfg. Co. v. Briggs Weaver, Inc.*, 549 S.W.2d 768, 769 (Tex. Civ. App.—Eastland 1977, writ dismissed); *Sheldon Petroleum Co. v. Pierce*, 546 S.W.2d 954, 956 (Tex. Civ. App.—Dallas 1977, no writ); *Zurich Ins. Co. v. Wieggers*, 527 S.W.2d 511, 514 (Tex. Civ. App.—Austin 1975, no writ).

139. For example, the legislature increased filing fees for articles of incorporation, reservation of names, change of address of registered agent, articles of dissolution, assumed name filings, and professional association filings. See TEX. BUS. CORP. ACT ANN. art. 10.01 (Vernon Supp. 1984).

Article 5.13 of the Act was amended to require the corporation to make a notation in its records that a demand has been made with respect to specific shares if a right of dissent and



these numerous changes, a routine check of legal requirements should be made before filing even familiar documents if a delay would be inconvenient.

## II. JUDICIAL DEVELOPMENTS

Following the general structure of recent annual surveys, the cases involving partnerships and "piercing the corporate veil" are first discussed, followed by other corporation and securities cases.

### A. Partnership Cases

Two cases arising during the survey period involved the issue of whether a partnership was created by an express agreement. In *Gutierrez v. Yancy*<sup>140</sup> the court considered an agreement by which one participant contributed the use of land for a farming venture and his personal services in producing a crop of onions, the second contributed capital, and the third

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appraisal is sought. In addition, if the shares are certificated, the certificates must be submitted for notation within 20 days or the right of appraisal is lost. *Id.* art. 5.13, § B.

The legislature amended article 5.01, § B(4) of the Act to clarify that in a merger an exchange of property or cash for shares as well as a conversion of shares into property may be made, and that shares of a corporation other than the corporation that is a party to the merger may be the subject of exchange in a merger. *Id.* art. 5.01, § B(4). These amendments probably did not affect the substance of the article, but did clarify its intent. Article 2.06A of the Texas Miscellaneous Corporation Laws Act was amended to authorize a parent corporation to create indebtedness if a wholly owned subsidiary, rather than the corporation itself, received the "money paid, labor done, which is reasonably worth at least the sum" of the indebtedness under the constitutional provision. TEX. REV. CIV. STAT. ANN. art. 1302—2.06A (Vernon Supp. 1984).

If a registered agent wishes to resign, he must give written notice to the corporation at its last known address and must file a written notice in duplicate with the secretary of state within 10 days after giving notice to the corporation. TEX. BUS. CORP. ACT ANN. art. 2.10, § D (Vernon Supp. 1984). The second notice must include the last known address of the corporation and a statement that written notice of resignation has been given to the corporation, and the date thereof. The appointment of such an agent terminates 30 days after receipt of such notice by the secretary of state. *Id.* No fee for filing the notice of resignation is assessed. *Id.* The secretary of state endorses both the original and the copy, files the original in his office, returns the copy to the resigning registered agent, and notifies the corporation of the resignation of the registered agent. *Id.*

In 1967 the legislature adopted a streamlined procedure if the change only involves moving the registered office within a single county. *Id.* art. 2.10—1 (Vernon 1980). In 1983 the single county restriction was removed, so that this procedure may be utilized by a registered agent changing its address anywhere within the state. *Id.* art. 2.10—1 (Vernon Supp. 1984). The 1983 amendment also conformed and simplified the filing requirements. It is not necessary to list the "post office" address of the agent's old and new addresses, and, if the registered agent is simultaneously filing statements as to more than one corporation, each statement may contain facsimile signatures. *Id.* Only the original and one copy of the statement need be filed with the secretary of state; the copy is returned to the registered agent, and there is no requirement that the corporation be notified of the change in address. *Id.* In this context, the 1983 amendment relating to venue of actions against corporations changed the general standard from "the county in which its registered office is situated" to the county of its "principal office." See *supra* notes 135-38 and accompanying text. The result is that a change of location by a registered agent from one county to another does not itself affect the venue of actions.

140. 650 S.W.2d 169 (Tex. App.—San Antonio 1983, no writ).

contributed only his services. Profits were to be shared in specified percentages, but there was no reference to the sharing of losses.

The venture was not profitable, and the capital-contributing participant sought to compel contributions toward the losses by the other participants. At first blush this arrangement would appear to be the classic partnership, with losses shared in accordance with the profits under section 18(1) of the Texas Uniform Partnership Act.<sup>141</sup> Because of earlier case law in Texas that placed excessive weight on the express sharing of losses as a determinant of whether a joint venture exists,<sup>142</sup> however, the court concluded that the plaintiff had not sustained the burden of proof of showing that a partnership existed.<sup>143</sup> The court quoted section 7(4) of the Texas Uniform Partnership Act: "The receipt by a person of a share of the profits of a business is prima facie evidence that he is a partner in the business, but no such inference shall be drawn [in certain situations.]"<sup>144</sup> The court refused to conclude that this "inference" was sufficient to impose the burden on the defendant to establish that a relationship other than a partnership was created despite the sharing of profits. Instead the court pointed out that expenses of production and marketing were to be paid solely by the capital-contributing participant, and that virtually no property was held in common.<sup>145</sup> The court concluded that the "trial court could have construed the agreement as one to share profits as compensation under a profit sharing agreement."<sup>146</sup> The case does not seem to conform with the general intention of the Uniform Partnership Act to create a presumption of partnership when there is a sharing of profits.

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141. TEX. REV. CIV. STAT. ANN. art. 6132b, § 18(1) (Vernon 1970).

142. See, e.g., *Tex-Co Grain Co. v. Happy Wheat Growers, Inc.*, 542 S.W.2d 934, 936 (Tex. Civ. App.—Amarillo 1976, no writ) (agreement not a joint venture because it provided only for sharing profits and not losses); *Fry v. Shaw*, 508 S.W.2d 142, 146 (Tex. Civ. App.—Dallas 1974, writ ref'd n.r.e.) (no joint venture found); *Ames v. Texas Gulf Indus., Inc.*, 411 S.W.2d 779, 782 (Tex. Civ. App.—Texarkana 1967, no writ) (agreement to develop and sell land not joint venture because of lack of control and no sharing of losses). For sources advocating that loss sharing is not a requisite of a joint adventure, see A. BROMBERG, CRANE AND BROMBERG ON PARTNERSHIP § 35 (1968); 19 R. HAMILTON, TEXAS PRACTICE § 61 (Supp. 1982); Aldave, *Corporations and Partnerships, Annual Survey of Texas Law*, 33 Sw. L.J. 239, 240 (1979). For extensive discussion of the loss sharing problem in joint adventures, see generally Comment, *The Sharing of Losses Dilemma*, 18 U. MIAMI L. REV. 429 (1963).

143. 650 S.W.2d at 172.

144. TEX. REV. CIV. STAT. ANN. art. 6132b, § 7(4) (Vernon 1970) provides:

The receipt by a person of a share of the profits of a business is prima facie evidence that he is a partner in the business, but no such inference shall be drawn if such profits were received in payment:

- (a) As a debt by installments or otherwise,
- (b) As wages of an employee or rent to a landlord,
- (c) As an annuity to a widow or representative of a deceased partner,
- (d) As interest on a loan, though the amount of payment vary with the profits of the business,
- (e) As the consideration for the sale of a good-will of a business or other property by installments or otherwise.

145. 650 S.W.2d at 172.

146. *Id.*

The second case, *Hodges v. Braun*,<sup>147</sup> involved a much more unusual set of facts. Two doctors began practicing medicine together under an agreement that provided for the pooling of net income and then dividing it according to predetermined ratios that varied from 65/35 during the first year to 50/50 during and after the third year. The two doctors maintained separate bank accounts, however, into which each deposited his own fees. At the end of each month a separate ledger was set up, all expenses were posted, and the net income determined; at that point the ratio was applied and the doctor who was "short" received a check from the other. One of the doctors testified that this unusual method of accounting was established "because we didn't want to be considered as partners." The case arose when one of the participants discovered that the other was not including all his income; the participant argued that a partnership existed and omission of some income or at least the other participant's failure to disclose that he planned to omit some income, constituted a breach of fiduciary duty.<sup>148</sup> To complicate matters even further, the pleadings of both parties alleged that a partnership existed while both parties testified at the trial that no partnership existed.<sup>149</sup> The court did not cite the Uniform Partnership Act, but reached the common sense conclusion that persons who testify that they are not partners should not be held to a partnership responsibility in the absence of reliance by a third person on the appearance of partnership.<sup>150</sup> The court also concluded that Hodges's testimony that he and Braun were not partners was a "quasi admission" binding upon him.<sup>151</sup>

Other partnership cases decided during the survey period involve a miscellany of issues. In *Bragg v. Bray Employment Co.*<sup>152</sup> the Eastland court of appeals held in a questionable decision that venue of a suit against a partner on a partnership obligation should be determined as though the suit were based on an individual obligation. The partnership lease for agricultural goods, which was the subject of the suit, was signed by the defendant's partner (apparently because the defendant was temporarily out of the office "doing something with the machines"). Suit was brought in the county in which the lease was signed;<sup>153</sup> the court accepted the argu-

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147. 654 S.W.2d 542 (Tex. App.—Dallas 1983, writ ref'd n.r.e.).

148. The jury found that the parties did not intend that all of Braun's income be included in the pool, so on appeal the plaintiff shifted his argument to the nondisclosure point.

149. 654 S.W.2d at 544.

150. *Id.* The court distinguished *Howard Gault & Son, Inc. v. First Nat'l Bank*, 541 S.W.2d 235 (Tex. Civ. App.—Amarillo 1976, no writ), which held a putative partner liable to a third person despite an internal agreement that the participants were not partners.

151. 654 S.W.2d at 544. The court relied on *Mendoza v. Fidelity & Guar. Ins. Underwriters, Inc.*, 606 S.W.2d 692 (Tex. 1980), in which the Texas Supreme Court set forth the technical requirements that must be satisfied before a quasi admission may be treated as a judicial admission. The *Hodges* court concluded that Hodges's admission satisfied all of the requirements, so that Hodges had sworn himself out of court. 654 S.W.2d at 544-45.

152. 649 S.W.2d 119 (Tex. App.—Eastland 1983, no writ).

153. TEX. REV. CIV. STAT. ANN. art. 1995, § 5(b) (Vernon Supp. 1982-1983) (amended 1983) provides: "In an action founded upon a contractual obligation . . . suit by a creditor . . . may be brought . . . either in the county in which the defendant in fact signed the contract, or in the county in which the defendant resides . . . ."

ment that the defendant had not "signed" the lease and therefore venue was proper only in the county of the defendant's residence.<sup>154</sup>

In *Durkin v. American General Fire & Casualty Co.*<sup>155</sup> one partner flatly refused to sign an indemnification agreement. His co-partner thereafter executed the agreement in the partnership name. Since the obligation was within the scope of the partnership business, its execution was within the actual authority of the co-partner, and the original partner was liable on the agreement despite his refusal to sign it.<sup>156</sup>

The Texas attorney general has ruled that a foreign professional corporation may not qualify to transact business in Texas.<sup>157</sup> Further, the attorney general had previously ruled that a corporation could not be a general partner in a Texas partnership without qualifying to transact business in this state.<sup>158</sup> As a result, a District of Columbia attorney who had formed a one-person professional corporation could not substitute that corporation for himself as a general partner in a Texas law firm; the attorney must form a Texas professional corporation.<sup>159</sup>

### B. Formation of a Corporation to Avoid Usury

In *RepublicBank Dallas N.A. v. Shook*<sup>160</sup> the Texas Supreme Court considered the extent to which creditors and debtors may utilize the corporate form to take advantage of the higher usury limitations on loans to corporations. In *Shook* the bank had lent large sums of money individually to Shook on a secured basis at the maximum lawful interest rate in Texas. By late 1973 interest rates had risen so that the prime rate was above the maximum lawful rate in Texas on loans to individuals; at the same time the value of Shook's security had declined precipitously so that a foreclosure would have caused large losses to both borrower and lender. Shook refused to have the loan taken over by a family corporation with substantial assets and his wife refused to pledge her separate property as additional security on the loan. A new agreement was thereafter worked out: Shook formed a wholly owned corporation that borrowed funds from the bank at a significantly higher interest rate; these funds were distributed to Shook, who used them to pay off his personal obligations, including the note held by the bank. Shook personally guaranteed the corporation's note. Shook finally worked his way out of the financial bind. The collateral for the bank's loan increased in value so that the loan was not "under water" by 1976 and was not longer classed by the bank as a "trouble loan" by 1979. At this time, however, Shook filed suit claiming that the loan to the corpo-

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154. 649 S.W.2d at 120. The court noted that the plaintiff did not name the partnership itself as a defendant. *Id.*

155. 651 S.W.2d 41 (Tex. App.—Tyler 1983, writ ref'd n.r.e.).

156. *Id.* at 45.

157. Op. Tex. Att'y Gen. No. JM-7 (1983).

158. Op. Tex. Att'y Gen. No. WW-191 (1958).

159. Op. Tex. Att'y Gen. No. JM-7 (1983).

160. 653 S.W.2d 278 (Tex. 1983).

ration was a device to evade the Texas usury laws;<sup>161</sup> he demanded twice the amount of interest paid while the bank counterclaimed for the unpaid balance of the loan.

The jury found that the creation of the corporation was "a device or subterfuge" to allow the bank to charge a higher rate of interest to Shook, the true borrower, than allowed by the Texas usury statute.<sup>162</sup> The trial court ignored this finding and entered judgment for the bank. The court of appeals reversed, rendering judgment for Shook,<sup>163</sup> and the Texas Supreme Court in turn reversed the court of appeals and upheld the transaction.<sup>164</sup>

The use of a corporation to avoid a usury defense first became possible in Texas in 1967 when different usury rates for corporations and for individuals were established by legislation. Different usury rates for corporate and individual loans, however, have long been in effect in many other states. Indeed, in many states there is a usury limitation applicable to loans to individuals but no limitation applicable to loans to corporations.

The Texas Supreme Court made a careful review of the treatment this problem has received in other states. The court described two different approaches in other jurisdictions as to the availability of a usury defense when personal indebtedness is converted to corporate indebtedness in order to permit a higher level of allowable interest.<sup>165</sup> The majority or "New York rule" distinguishes between a loan made "for a purely personal and necessitous purpose" and one made for a personal "business or commercial enterprise."<sup>166</sup> A loan made for the former purpose is usurious even though placed in a corporation; a loan made for the latter purpose is not. The minority or "New Jersey rule" treats the issue as a question of fact as to whether the corporation was used as a device to conceal a usurious transaction with an individual.<sup>167</sup> This "question of fact" may turn on

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161. The legislature amended the statute governing interest rates on loans to individuals in 1981 and 1983. TEX. REV. CIV. STAT. ANN. art. 5069—1.04 (Vernon Pam. Supp. 1971-1983). The predecessor of art. 5069—1.04, applicable to *Shook*, provided for a maximum rate on loans to individuals of 10%. Interest-Consumer Credit and Consumer Protection Act, ch. 274, § 2, 1967 Tex. Gen. Laws 609, 609-10, amended by Act of May 8, 1981, 1981 Tex. Gen. Laws, ch. 111, § 5, 274. The maximum rate allowed on corporate loans was 1.5% per month. TEX. REV. CIV. STAT. ANN. art. 1302—2.09 (Vernon 1980). (The legislature added section 2.09A in 1981, which provides as an alternative maximum, that a corporate loan rate may not exceed the floating rate specified by art. 5069—1.04, amended on the same date.) Given the disparity between maximum rates on corporate and personal loans at the time, the bank in *Shook* clearly had incentive to structure the transaction as a corporate loan.

162. 653 S.W.2d at 279.

163. *Shook v. Republic Nat'l Bank*, 627 S.W.2d 741, 752 (Tex. App.—Tyler 1981). The court of appeals reversed and remanded the portion of the trial court's judgment awarding attorneys' fees to Republic for redetermination of the reasonableness of the fees. *Id.* at 750, 753.

164. 653 S.W.2d at 282-83. The court also reinstated the trial court's original award of attorneys' fees to Republic.

165. *Id.* at 280.

166. *Id.* (quoting *Schneider v. Phelps*, 41 N.Y.2d 238, 391 N.Y.S.2d 568, 571, 359 N.E.2d 1361, 1364 (1977)).

167. 653 S.W.2d at 280. The court listed several factors considered by courts using the

factors such as the voluntariness of incorporation, the corporation's financial strength, the purpose of the loan, and the experience of the borrower. A survey of the numerous decisions by Texas courts of appeals since 1967 persuaded the Texas Supreme Court that there was a definite trend within the majority of decisions to follow the "New York rule," and the court ultimately adopted that rule for Texas.<sup>168</sup>

In applying this rule to the transaction before it, the court categorized the loan to Shook as "in furtherance of his personal business enterprise."<sup>169</sup> Shook also argued that the transaction was in effect a renewal of a personal loan; the court rejected this argument on the ground that since the bank could call in the loan, the transaction was a "new" loan rather than the "renewal" of a loan. All of this was too much for Justices Spears and Kilgarlin, who, relying on the jury finding that this "was a device or subterfuge to evade the laws prohibiting usury," argued that "in no other area of the law but usury do the courts approve a subterfuge to evade the law."<sup>170</sup>

In periods of high interest rates, usury laws tend to have counterproductive results since persons will be denied credit if the legal rate is below the rate that the market requires for the transaction in question. Usury laws, however, have a strong political appeal so that the typical legislative response to a restrictive usury law is to amend it rather than to repeal it. Anyone reading the present Texas usury statutes will concur that they have become exceptionally complex and probably have little practical effect except perhaps upon the marginal transaction. It is interesting that the opinion of the majority of the Texas Supreme Court in the *Shook* case seems to rest as much on policy justifications as upon the categorization of the transaction. The court stated that to prohibit a personal loan from being renegotiated at corporate rates "would cause unjust results" since it "would prevent the borrower sufficient leeway to protect himself especially when a renewal might result in a successful pay back plus profits" and "[t]he formation of a corporation at least gives the borrower a choice."<sup>171</sup> The court concluded this discussion by commenting that "obtaining money at a higher interest rate does not necessarily preclude profits for both lenders and borrowers and it is often preferable over the alternative of not having access to the money at all."<sup>172</sup>

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New Jersey rule, citing Note, *Incorporation for the Purpose of Borrowing at an Otherwise Usurious Rate of Interest: Skeen v. Glenn Justice Mortgage Co.*, 29 Sw. L.J. 959, 962 (1975).

168. 653 S.W.2d at 281. The court also relied on TEX. REV. CIV. STAT. ANN. art. 5069—1.04(b)(2) (Vernon Pam. Supp. 1971-1983), which distinguishes between loans for a "business, commercial, investment, or other similar purpose" (for which a maximum rate of 28% per year is provided if the loan is in excess of \$250,000), and loans for a "personal, family, household, or agricultural use" (for which a floating maximum rate between 18% and 24% is authorized). *Id.* The legislature added subsection (b)(2) during the general revision of art. 5069—1.04 in 1981. *See supra* note 161.

169. 653 S.W.2d at 281.

170. *Id.* at 283 (Spears, J., dissenting).

171. *Id.* at 282.

172. *Id.*

In *Stanley v. Conner Construction Co.*,<sup>173</sup> also involving the usury defense, a corporate president executed a note on behalf of his corporation and also individually, in performance of his contractual commitment to "personally and individually guarantee this Contract and co-sign the real estate lien note."<sup>174</sup> The interest rate for the transaction was usurious if made to an individual but not usurious if made to a corporation. Relying on *Universal Metals & Machinery, Inc. v. Bohart*,<sup>175</sup> the court held that "guarantors of all kinds" are precluded from raising a usury defense when the transaction is not usurious to the principal debtor, in this case the corporation.<sup>176</sup>

### C. Corporate Names

The first case involving the legal status of the complex rules relating to name availability promulgated by the secretary of state<sup>177</sup> is *Ergon, Inc. v. Dean*.<sup>178</sup> The issue in the case was whether the secretary of state should be ordered to revoke his approval of the name "Ergon Energy Corporation," on the complaint of Ergon, Inc., a Mississippi corporation qualified to transact business in Texas. The plaintiff claimed that "Ergon" was a "fictitious, fanciful or arbitrary word" so that a letter of consent was needed under then rule 004.20.02.014.<sup>179</sup> The court held, however, that "Ergon" was not a "fanciful" name since it had an accepted dictionary—albeit not widely used—meaning. Hence the court concluded that the secretary had acted consistently with his own regulations.<sup>180</sup> In the course of its opinion, the court stated that "[a] violation of these rules is the functional equivalent of a violation of the statute,"<sup>181</sup> a statement that must have been pleasing to the office of the secretary of state.

### D. Piercing the Corporate Veil

Two Fifth Circuit decisions during the survey period sharply illustrate the problems involved in determining when a subsidiary corporation should be viewed as the "alter ego" of its parent. In *Edwards Co. v. Mono-*

173. 651 S.W.2d 34 (Tex. App.—El Paso 1983, no writ).

174. *Id.* at 36.

175. 539 S.W.2d 874 (Tex. 1976).

176. 651 S.W.2d at 38-39.

177. Sec'y of State, 1 TEX. ADMIN. CODE §§ 79.31-.54 (Shepard's 1982) (corporate name availability).

178. 649 S.W.2d 772 (Tex. App.—Austin 1983, no writ).

179. At the time, this rule provided:

A proposed corporate name may be deemed "similar requiring a letter of consent" if any of the following conditions exist:

(3) Names containing a fictitious, fanciful, or arbitrary word may not be available without a letter of consent, although the name might seem to be available under other rules. EXAMPLE: Entex Production Company is not available without a letter of consent from Entex, Inc.

*Id.* at 775.

180. *Id.*

181. *Id.* at 774.

*gram Industries*<sup>182</sup> the court held that the parent corporation, Monogram, was liable for the contract debts of its wholly owned subsidiary, Monotronics, which was in turn the general partner in a limited partnership engaged in the business of manufacturing and selling smoke alarms under the name Entronic Company. Monotronics was formed for the purpose of acquiring the smoke alarm business by purchasing with cash provided by Monogram. Monogram conducted the smoke alarm business under the name Entronic Company with scant respect for the separate existence of Monotronics, though there was no confusion of entities that misled creditors, no fraud, no inadequate capitalization, and no "milking" of the subsidiary. The corporate subsidiary, in short, was not abused but ignored.<sup>183</sup> The Fifth Circuit found that alter ego liability existed under Texas law because Monotronics

had no mind of its own, no body of its own, no will of its own, and, indeed, no existence of its own. . . . Time and time again, we see Monogram manipulating the Entronic finances and operation without the slightest regard for Monotronic's existence. Because, as Monogram well knew, Monotronics had no existence except as a piece of paper. And now, after almost completely disregarding Monotronic's existence, Monogram asks us to recognize it as a viable entity.<sup>184</sup>

In contrast, in *Miles v. American Telephone & Telegraph Co.*<sup>185</sup> the same court concluded that Southwestern Bell was not the alter ego of American Telephone & Telegraph Company even though Southwestern Bell was

182. 700 F.2d 994 (5th Cir.), *reh'g denied*, 713 F.2d 139 (5th Cir. 1983).

183. In denying a rehearing the court listed the relevant facts on which it relied:

2. All of the officers and directors of Monotronics were either officers or directors of Monogram.
3. Monotronics, although the "general partner" of Entronic Company, never exercised any control over Entronic.
4. Monotronics did not have any employees, pay any salaries or direct any production or sales policies or participate in such.
5. Monotronics had no telephone or office space.
6. Monogram paid for all expenses attributable to Monotronics such as stationary, patent search fees and filing fees.
7. Monogram performed all of Monotronics's bookkeeping and combined all of Monotronics's tax returns with its own.
8. Monogram obtained all credit and performed all financing for Monotronics/Entronic.
9. Just as Monotronics did not participate in the routine decisions regarding Entronic's affairs, neither did it participate with respect to the major decisions of Entronic's very life . . . .
10. Monotronics was, on occasion, not only a mere conduit for Monogram, but was completely ignored [The court cites as an example a loan made by Monogram directly to Entronic that was not recorded on Monotronics's books until several months later and was never repaid.]
11. The \$251,000 "capital" infused initially into Monotronics was never used except by Monogram for credit purposes or, when the venture was in extremis, to bankroll an attempted release of general unsecured creditors. This attempted release was subsequently nullified in bankruptcy court. None of the "capital" went to Entronic's creditors.

713 F.2d at 142.

184. *Id.* at 142-43.

185. 703 F.2d 193 (5th Cir. 1983).



wholly owned by AT&T, had one director in common, and had numerous business transactions and extensive areas of cooperation with its parent.<sup>186</sup> While AT&T required its subsidiaries to implement certain broad policies, it nevertheless permitted each subsidiary freedom in daily operations and autonomy in the conduct of its business and financial affairs, and each subsidiary, of course, was well able to satisfy any monetary judgment against it.<sup>187</sup>

Several other piercing-the-corporate-veil cases decided during the survey period reflect well-established principles. In *Moffett v. Goodyear Tire & Rubber Co.*<sup>188</sup> the plaintiff sought a recovery against a French subsidiary of the defendant upon learning that the tire that had caused the accident had actually been manufactured by the subsidiary. The court refused to pierce the corporate veil in this reverse situation because, even though Goodyear and its French subsidiary had five out of eight directors in common, the court concluded that the French subsidiary was not dominated and controlled by Goodyear and the two units' separate identities were maintained.<sup>189</sup>

*Sumrak v. Tenneco Oil Co.*<sup>190</sup> was an injury-in-a-store case, in which plaintiff brought suit against "Tenneco, Inc." the apparent owner of the store. That corporation answered through an attorney and responded to interrogatories. The day after the statute of limitations had expired, however, it filed a motion requesting that "Tenneco Oil Company," a second tier subsidiary of Tenneco, Inc., be substituted as party defendant since it was the true owner of the store; thereafter the court granted a motion for an instructed verdict on the ground that the statute of limitations had expired before suit was brought against Tenneco Oil Company. The court of appeals refused to pierce the corporate veil, but applied the *Continental Southern Lines* reasoning<sup>191</sup> to permit suit to be maintained against Tenneco Oil Company since Tenneco, Inc., had made no effort to substitute Tenneco Oil Company prior to the running of the statute of limitations

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186. *Id.* at 197. The plaintiff also sued South Central Bell, another subsidiary that had no directors in common with the parent corporation.

187. The court did not explain why the plaintiff originally brought suit against the parent corporation rather than the subsidiaries who allegedly released telephone records in violation of the plaintiff's right of privacy.

188. 652 S.W.2d 609 (Tex. App.—Austin 1983, no writ).

189. *Id.* at 614. Citing *Gentry v. Credit Plan Co.*, 528 S.W.2d 571 (Tex. 1975), the court listed several factors for determining whether a subsidiary is simply a conduit through which the parent conducts its business. These factors include whether the two file consolidated tax returns, whether they keep separate books, whether they have common business departments, whether the subsidiary borrows capital from the parent or external sources, whether the two hold separate meetings of shareholders and directors, and whether an officer of one corporation determines policy for the other. 652 S.W.2d at 613.

190. 648 S.W.2d 778 (Tex. App.—Fort Worth 1983, no writ).

191. *Continental S. Lines, Inc. v. Hilland*, 528 S.W.2d 828 (Tex. 1975), held that in cases of this character the plaintiff's suit should not be dismissed unless the true defendant was misled or placed at a disadvantage in obtaining evidence to defend the suit. The substitution of the parties defendant under TEX. R. CIV. P. 28 is appropriate in this situation even after the statute of limitations has expired. See 19 R. HAMILTON, *supra* note 142, § 240 (concluding that Texas Supreme Court in *Continental Southern Lines* foreclosed use of the "laying behind the log" tactic attempted in *Sumrak*).

and the latter was not misled or placed at a disadvantage in obtaining evidence needed to defend the suit.<sup>192</sup>

*Hickman v. Rawls*<sup>193</sup> is the classic contracts case refusing to apply the piercing the corporate veil doctrine. The plaintiffs agreed to do certain designs and drawings for the defendant corporation's contemplated project. The corporation turned out not to have sufficient assets to pay the plaintiffs' fee, and the plaintiffs sought to recover from the shareholders individually on the theory that the corporation knew it did not have assets sufficient to pay them when the work was commissioned, that the corporation failed to maintain proper financial records, and that it failed to follow appropriate corporate formalities. There was no showing of fraud or of an illegal scheme. The court held that the shareholders were not liable, saying that the separate corporate existence should be ignored under only "the most extraordinary circumstances," and that "the overriding public policy necessary to disregard the corporate entity must be more stringent in contract cases than in tort cases because in contract cases the plaintiff has an opportunity to select the entity with which he deals as opposed to tort cases in which no such choice exists."<sup>194</sup> In this case the plaintiffs argued that they did not know they were dealing with a corporation, but that argument was rejected, since the contract on its face showed that it was executed by a corporation, not by an individual.

Many cases hold that the doctrine of piercing the corporate veil is not available to the corporation or its shareholders when it works to their advantage. A tax case decided during the survey period, *Delta Pipe Fabricators v. Bullock*,<sup>195</sup> held that a corporation cannot reduce its sales and use taxes by combining its operations with the operations of a wholly owned subsidiary performing similar work.<sup>196</sup> The subsidiary was formed for reasons unrelated to taxes: in response to a union demand that two separate contracts be entered into, one for field workers employed by the corporation and one for workers in a "pipe shop" operated by the subsidiary.

Finally, in *Dodd v. Charles Jourdan Boutique, Inc.*<sup>197</sup> a corporation named "Dodman, Inc." was duly formed and an assumed name certificate was filed reflecting that its business would be conducted under the name "Centipede Shoe Fashions." Unfortunately, however, the two owners of the business thereafter conducted business in their own names "doing business as Centipede Shoe Fashions." The owners claimed that they had advised the plaintiff of the existence of Dodman, Inc., a claim that the plaintiff denied, and the jury rejected. Applying traditional agency law, the court concluded that the owners were personally liable on the obligations under the general agency principle that an agent for an undisclosed

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192. 648 S.W.2d at 782.

193. 638 S.W.2d 100 (Tex. App.—Dallas 1982, no writ).

194. *Id.* at 102.

195. 638 S.W.2d 652 (Tex. App.—Austin 1982, writ ref'd n.r.e.).

196. *Id.* at 653.

197. 648 S.W.2d 763 (Tex. App.—Corpus Christi 1983, no writ).

principal is personally liable on the obligation.<sup>198</sup> Arguments about the separate corporate existence of the corporation, confusion of personal and corporate affairs, and piercing the corporate veil were apparently not put forward.

### E. Duty of Care

In *Meyers v. Moody*<sup>199</sup> the Fifth Circuit applied Texas law relating to the duty of care of directors and officers to an Alabama insurance company qualified to transact business in Texas under the Texas Insurance Code.<sup>200</sup> In this case the sole shareholder of an insurance company contributed a life interest in a trust to the company, and thereafter artificially valued this asset so as to create a surplus that enabled the company to use corporate assets to acquire other insurance companies. Ultimately, the defendant's unusually aggressive and leveraged expansion program led to the collapse of the insurance company. The sole shareholder was held personally liable as an officer and director for the losses suffered by policy holders upon jury findings that he acted "negligently" and that his behavior amounted to "intentional misconduct or gross negligence."<sup>201</sup> The court held the business judgment rule did not protect the shareholder from liability for either the excessive appraisal of the life interest or the use of

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198. *Id.* at 766.

199. 693 F.2d 1196 (5th Cir. 1982).

200. The court based its conclusion that Texas law should apply to the defendant on rather attenuated reasoning. The normal conflicts rule is that the law of the state of incorporation (Alabama) controls the duties of officers and directors under the general internal affairs principle. *See, e.g.,* *Graham v. New Mexico E. Gas Co.*, 141 S.W.2d 389, 391 (Tex. Civ. App.—Dallas 1940, no writ) (recognition by court of general rule preventing interference with internal affairs of foreign corporation); *Zarate v. Ateca*, 99 S.W.2d 628, 631 (Tex. Civ. App.—El Paso 1936, writ dismissed) (court refusal to order distribution by Mexican corporation of assets to shareholders); *Royal Fraternal Union v. Lunday*, 113 S.W. 185, 187 (Tex. Civ. App. 1908, no writ) (dismissal when plaintiff sought injunction against Missouri insurance company doing business in Texas under permit from state commissioner of insurance because of lack of jurisdiction to supervise internal affairs of out-of-state insurance company). The court, however, relied on TEX. BUS. CORP. ACT ANN. art. 9.14, § A (Vernon 1980), which provides that the Act does not apply to foreign corporations qualified to transact business in Texas under a special statute such as the Insurance Code and contains the following proviso:

[I]f . . . any such excepted foreign corporations were . . . granted authority to transact business within this State under any special statute which contains no provisions in regard to some of the matters provided for in this Act in respect of foreign corporations, . . . then the provisions of this Act shall apply to the extent that they are not inconsistent with the provisions of such special statutes.

Since the Texas Insurance Code does not define duties of directors and officers, the court relied on TEX. BUS. CORP. ACT ANN. art. 8.02, § A (Vernon 1980), which provides that officers and directors of qualified foreign corporations "shall be subject to the same duties, restrictions, penalties, and liabilities now or hereafter imposed upon a domestic corporation of like character and its officers and directors." The court concluded, therefore, that the defendant "was subject to the same duties and liabilities that Texas law imposes upon officers and directors of Texas corporations," without squarely concluding that Texas law itself controlled the relationship between the corporation and its directors. 693 F.2d at 1209.

201. *Id.*

corporate assets without regard to the interests of the policy holders.<sup>202</sup> After holding the defendant liable, the court considered the appropriate measure of damages, an issue on which virtually no Texas authority exists. The jury had determined that \$5,000,000 would "fairly and reasonably compensate [the corporation] for damages caus[ed] by [Moody's] negligent mismanagement, breach of fiduciary duties [and federal] securities violation."<sup>203</sup> The jury also awarded \$1,000,000 in punitive damages. The Fifth Circuit affirmed this award, relying on analogies to (1) suits involving the liability of corporate directors to creditors for utilizing false financial statements, (2) suits involving fraud or deceit in general, and (3) suits involving negligent mismanagement.<sup>204</sup>

*Anbeck Co. v. Zapata Corp.*<sup>205</sup> involved the interpretation of a "work out" agreement that provided that the price of a business purchased by Zapata Corporation was dependent to some extent on the profits of the business following the sale. The sellers of the business relinquished the power of management following the sale, so that the sellers' entitlement to the "work out" portion of the purchase price depended on the skill and competence of the managers installed by Zapata. The business did not earn the profit required to entitle the seller to the increased purchase price. The sellers sued, claiming that the conditions had been waived because Zapata intentionally prevented the business from attaining the stipulated level of profits, or alternatively, that Zapata's negligence or failure to use reasonable diligence caused the shortfall in profit. The contract did not directly address the general standard of care in management that Zapata was required to follow. The sellers argued that the standards of reasonable diligence and due care generally applicable to directors of business corporations were applicable.<sup>206</sup> Zapata, on the other hand, argued that the standard should be the more general one of "good faith and fair dealing." The trial court concluded that the standard proposed by Zapata was the appropriate one, and so instructed the jury. The appellate court affirmed; it viewed the issue ultimately as a matter of intention as expressed in the contract rather than as a general standard of conduct for corporations

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202. *Id.* The lower court also held that the defendant violated rule 10b-5, 17 C.F.R. § 240.10b-5 (1983), since he failed to disclose his belief that the trust instrument was not transferable and he fraudulently misrepresented the value of the life interest. 475 F. Supp. 232, 243 (N.D. Tex. 1979). The Fifth Circuit did not pass on this theory, since the court concluded that the damages recovered could be supported on the state common law theories of fraud and breach of fiduciary duty to shareholders. 693 F.2d at 1211.

203. 693 F.2d at 1215.

204. *Id.* at 1213.

205. 641 S.W.2d 608 (Tex. App.—Houston [14th Dist.] 1982, writ ref'd n.r.e.).

206. The sellers relied on the definition of due care that appears in § 35 of the Model Business Corporation Act in formulating the following definition of reasonable diligence: Reasonable diligence in management as used herein means that the person or persons making and implementing management decisions used that degree of diligence which would be used by a person of ordinary prudence under the same or similar circumstances to investigate and obtain the relevant and available facts and exercised such diligence in making and implementing such decisions based upon such facts.

MODEL BUS. CORP. ACT § 35 (Supp. 1979).

since it relied upon contextual arguments based on contract language, the history of the negotiation, and the presence of a broad merger clause in the contract.<sup>207</sup> Perhaps the most important lesson to be learned from the *Anbeck* case is the importance of the seller's retention of control over the management of a business if the contract contains a "work out" clause under which a portion of the compensation is dependent on the future operations of the business. If control is not retained, it is important to provide some contractual guidance as to how much effort must be made and what degree of skill is to be expected of the managers designated by the purchaser. This solution is much less satisfactory, however, since the application of any general standard is going to be difficult and different formulations may not affect the outcome in close cases.

#### F. Miscellaneous Corporate Issues

Two cases arising during the survey period involved the authority of corporate agents to use corporate funds deposited with a bank or savings and loan association, and the responsibility of the financial institution for the misuse of those funds. In *Collins County Savings & Loan Association v. Miller Lumber Co.*<sup>208</sup> Miller, acting as agent for Miller Lumber Company, deposited corporate funds in the Savings & Loan Association and received a certificate of deposit issued in the name of the corporation. Thereafter he borrowed a large sum of money individually from the Association and purported to pledge the corporation's certificate to secure its repayment.<sup>209</sup> Miller defaulted on his loan. When the corporation later sought to redeem the certificate, the Association claimed that it was entitled to offset Miller's unpaid loan against the proceeds of the certificate. In the subsequent suit for conversion, the Association lost: the loan to Miller was a personal loan and not a corporate loan, and there was no showing that Miller had authority to use corporate assets to secure his personal debt.<sup>210</sup> This conclusion is clearly correct, and the actions of the Association appear to be a textbook example of sloppy banking practices.

In *Upper Valley Aviation, Inc. v. Mercantile National Bank*<sup>211</sup> the general manager of a corporation directed the bank to transfer corporate funds to the account of another corporation that he controlled and that was indebted to the bank. The bank made the transfer under questionable circumstances and later used the funds to offset the unpaid loan. The bank succeeded in obtaining summary judgment in a suit brought by the original corporate depositor to recover the funds, but the appellate court re-

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207. 641 S.W.2d at 613-14.

208. 653 S.W.2d 114 (Tex. App.—Dallas 1983, no writ).

209. Despite this pledge, Miller did not deliver possession of the corporation's certificate to the Association even though the Association's president testified that standard banking practice required the Association to take possession of a certificate that is pledged as collateral for a loan.

210. 653 S.W.2d at 117.

211. 656 S.W.2d 952 (Tex. App.—Dallas 1983, writ ref'd n.r.e.).

versed and remanded for trial.<sup>212</sup> Foley, the bank's loan officer, had required execution of a corporate resolution on a standardized bank form before authorizing the transfer; the general manager signed the form as "secretary" and his wife signed it as "vice president," even though neither was an officer of the corporation. There was some evidence that Foley knew the resolution was "bogus." Foley also requested a letter authorizing the transaction, but permitted the transfer to occur upon the manager's promise to supply one without actually receiving the letter. Given these facts, the court held that summary judgment was improper since it could not be concluded as a matter of law that the general manager had either implied or apparent authority to withdraw the funds on his sole authority.<sup>213</sup>

Three cases decided by the Corpus Christi court of appeals during the survey period involved the issue of whether exemplary damages should be assessed against the corporation. The test in these cases is usually whether the agent who is acting is a "managerial agent," that is, one whose actions may be deemed to be actions of the corporation itself.<sup>214</sup> In *Canon, U.S.A. v. Carson Map Co.*<sup>215</sup> a regional service manager was found to be acting within a managerial capacity when he made certain product misrepresentations, but the court held that the action involved only a breach of contract for which exemplary damages do not lie.<sup>216</sup> In *Houston Lighting & Power Co. v. Sue*,<sup>217</sup> the court awarded exemplary damages when corporate agents acted "with conscious indifference" to rights of the plaintiff in not closing gates or maintaining fences on an easement over which the plaintiff grazed cattle.<sup>218</sup> In *Western Construction Co. v. Valero Transmission Co.*<sup>219</sup> the court held that the negligence of a managerial agent was not sufficiently established to permit the award of exemplary damages.<sup>220</sup>

In *Engel v. Teleprompter Corp.*<sup>221</sup> the court held that a restriction effective when a shareholder proposes to "sell or otherwise dispose of" shares was not triggered by an indirect transfer, that is, the transfer of all the

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212. *Id.* at 958. The trial court granted summary judgment based in part on the incorrect theory that the two-year statute of limitations for conversion, rather than the four-year statute for breach of a depository contract applied to the suit.

213. *Id.* at 957-58. The court further noted that the checks used to originally deposit the funds in the first corporation's account bore the signature of both the sole shareholder and the general manager. The court suggested that this fact should have put the loan officer on notice that the general manager may not have had authority to transfer the funds. *Id.*

214. See *Treasure City v. Strange*, 620 S.W.2d 811 (Tex. Civ. App.—Dallas 1981, no writ).

215. 647 S.W.2d 321 (Tex. App.—Corpus Christi 1982, no writ).

216. *Id.* at 323.

217. 644 S.W.2d 835 (Tex. App.—Corpus Christi 1983, writ ref'd n.r.e.).

218. *Id.* at 839-41. The court concluded that circumstantial evidence of the defendant corporation's wanton and willful conduct justified the award of \$125,000 in exemplary damages. *Id.* at 839.

219. 655 S.W.2d 251 (Tex. App.—Corpus Christi 1983, no writ).

220. *Id.* at 254. The court stated that an award of exemplary damages against a corporation must be based on very specific findings of fact with respect to the corporate agent's acts that form the basis of the suit. *Id.*

221. 703 F.2d 127 (5th Cir. 1983).

shares of a corporation that owned a majority of the shares of the corporation whose shares were subject to the restriction. The scope of a share transfer restriction is a matter of intention, but the court stated that such restrictions are to be strictly construed and concluded that there was no clear indication that the parties intended such a broad restraint.<sup>222</sup> The court relied in part on the separate legal existence of the two corporations.

In a reverse stock split the number of shares held by each shareholder is reduced proportionally. For example, in a 1-for-5 split, each holder of five shares of the old stock becomes a holder of one new share. Reverse stock splits may be used as "freeze-out" or "squeeze-out" tactics since an appropriate choice of ratio may reduce the holdings of the freezeout target to a fraction of a share, and that fraction may be eliminated for cash under the fractional share provision.<sup>223</sup> The effect of this transaction is identical to a cash merger where the target of the freeze-out is compelled to accept cash for his shares. In *Lewis v. Knutson*,<sup>224</sup> however, the Fifth Circuit held that a reverse stock split in which each holder of a fractional share had the choice of "rounding up" to a whole share or accepting cash for his fractional share was not a "freeze-out" and therefore the test of entire or intrinsic fairness applicable to freeze-out transactions under Delaware law was not applicable.<sup>225</sup>

In *Robinson v. T.I.M.E.-DC, Inc.*<sup>226</sup> the court upheld a "spin off" of assets by the corporation through the device of creating a wholly owned subsidiary and then distributing the shares of the subsidiary to the shareholders of the parent corporation.<sup>227</sup> The distributed assets were the real estate owned by the corporation and did not affect the trucking business that was the major element of the corporation's business. The court concluded that the transaction involved an exercise of ordinary business judgment and did not involve a conflict of interest. The court also rejected an argument based on the articles of incorporation, which granted additional rights to the preferred shareholders (including the plaintiff) to receive certain payments in the event of the "liquidation" of the corporation. The spin off did not constitute a liquidation, according to the court, because the corporation continued in the trucking business following the spin off, and also because the articles of incorporation expressly provided that "[n]either the merger nor consolidation of the Corporation . . . nor a sale, transfer or lease of all or any part of the assets of the Corporation, shall be deemed to be a liquidation . . ." <sup>228</sup>

Section 8.405(b) of the Texas Business & Commerce Code requires the

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222. *Id.* at 134.

223. TEX. BUS. CORP. ACT ANN. art. 2.20 (Vernon 1980). For an example of this use of the reverse stock split, see *Teschner v. Chicago Title & Trust Co.*, 59 Ill. 2d 542, 322 N.E.2d 54 (1974).

224. 699 F.2d 230 (5th Cir. 1983).

225. *Id.* at 239.

226. 566 F. Supp. 1077 (N.D. Tex. 1983).

227. *Id.* at 1085.

228. *Id.* at 1081.

owner of a lost or stolen security to satisfy, among other things, "any other reasonable requirements imposed by the issuer" as a prerequisite to obtaining a substitute certificate.<sup>229</sup> In *Glaser v. Texon Energy Corp.*<sup>230</sup> the court held that a shareholder who failed to comply with a request from the issuer for additional information as to how the shares were acquired and the circumstances of their loss could not obtain a substitute certificate even though the jury had determined that he was the owner of the shares represented by the lost certificate.<sup>231</sup>

Finally, in *Global Natural Resources v. Bear, Sterns & Co.*<sup>232</sup> the appellate court reversed a temporary injunction granted by the trial court without notice and hearing on the ground that its practical effect would have been to give the plaintiff essentially what it was seeking on the merits.<sup>233</sup> The plaintiff had sought to enjoin a British company that was the target of a takeover attempt from completing a corporate acquisition that would have increased significantly the number of outstanding voting shares in friendly hands. The court accepted the argument that if the injunction had been granted, the merger would not have occurred and the aggressors might take over the company and disavow or disaffirm the transaction in question. The opinion of the court gives little indication of the basis of jurisdiction of the trial court in Dallas; similar suits to block the proposed transaction had been unsuccessful in England and in a federal district court in Cincinnati, Ohio.<sup>234</sup>

### G. Receiverships

In *Aubin v. Territorial Mortgage Co. of America, Inc.*<sup>235</sup> the appointment of a receiver on the trial court's own motion was upheld as not involving an abuse of discretion. A derivative action had originally been filed in which the applicant requested a restraining order against disbursement of corporate assets; a subsequent amendment to the complaint requested an appointment of a receiver. The defendant objected on the plausible ground that the applicant was not a creditor authorized to obtain a receiver under article 7.06 of the Texas Business Corporation Act.<sup>236</sup> The trial court, however, relied on the broader article 7.05<sup>237</sup> to appoint a receiver on its own motion, relying on the catch-all clause, "[i]n any other actions where receivers have heretofore been appointed by the usages of the court

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229. TEX. BUS. & COM. CODE ANN. § 8.405(b) (Vernon 1968).

230. 702 F.2d 569 (5th Cir. 1983).

231. *Id.* at 572.

232. 642 S.W.2d 852 (Tex. App.—Dallas 1982, no writ).

233. *Id.* at 855.

234. *Id.* at 853.

235. 640 S.W.2d 737 (Tex. App.—Houston [14th Dist.] 1982, no writ).

236. TEX. BUS. CORP. ACT ANN. art. 7.06, § A(4) (Vernon 1980). This article deals with receiverships to effect the liquidation of a corporation and authorizes appointment of a receiver on the petition of a creditor "if it is established that irreparable damage will ensue to the unsecured creditors of the corporation, generally, as a class . . ." *Id.*

237. TEX. BUS. CORP. ACT ANN. art. 7.05 (Vernon 1980). This article governs appointments of receivers to rehabilitate the corporation.



of equity."<sup>238</sup> In affirming, the court of appeals relied on broad language in earlier cases that Texas courts have broad discretionary and inherent power to appoint receivers even in the absence of statutory authority.<sup>239</sup> The court also rejected constitutional arguments based on the application of articles 7.05 and 7.06 to the particular case.<sup>240</sup>

In *Humble Exploration Co. v. Fairway Land Co.*<sup>241</sup> and *Humble Exploration Co. v. Walker*<sup>242</sup> the Dallas court of appeals resolved a hotly contested receivership proceeding originally brought by a group of working interest owners of producing oil wells against the operator. The court held that a receivership of the business of a corporation could be filed only under the Texas Business Corporation Act<sup>243</sup> rather than under articles 2293 through 2320c of the Texas statutes.<sup>244</sup> The court drew a distinction between a receivership for a "business" subject to the Texas Business Corporation Act and a receivership for "property or [a] fund" subject to article 2293. The court concluded, however, that the applicants had failed to meet the proof required on practically every necessary allegation for establishing a right to the appointment of a receiver under article 7.05 and ordered the receivership dissolved.<sup>245</sup> In a second opinion about a month later<sup>246</sup> the court of appeals issued a writ of prohibition against the trial judge who had continued the receivership despite the appellate court's opinion on the theory that the opinion had no effect until a mandate was issued. The appellate court held that its dissolution of the receivership operated *instantly* on the basis of an analogy to a reversal of an order granting a temporary restraining order.<sup>247</sup>

#### H. Dissolution, Forfeiture, and Reinstatement

The dissolution of closely held corporations often appears to be an informal and irregular process. *Holliday v. Henry I. Siegal Co.*<sup>248</sup> is a good

238. *Id.* art. 7.05, § A(3).

239. *See* *Berkshire Petroleum Corp. v. Moore*, 268 S.W. 484 (Tex. Civ. App.—San Antonio 1925, no writ).

240. 640 S.W.2d at 742.

241. 641 S.W.2d 934 (Tex. App.—Dallas 1982, writ ref'd n.r.e.).

242. 641 S.W.2d 941 (Tex. App.—Dallas 1982, no writ).

243. TEX. BUS. CORP. ACT ANN. arts. 7.04-.08 (Vernon 1980).

244. TEX. REV. CIV. STAT. ANN. art. 2293, § 1 (Vernon 1971) authorizes a receivership "between partners or others jointly owning or interested in any property or fund" if the plaintiff's claim is probable and the property or fund is "in danger of begin lost, removed or materially injured."

245. 641 S.W.2d at 939. The court set forth the requirements that an applicant must satisfy in order to justify appointment of a receiver under TEX. BUS. CORP. ACT ANN. art. 7.05, § A (Vernon 1980) and held that appointment of the receiver was improper because the applicants failed to show: (1) that they were creditors, shareholders, or that courts of equity formerly appointed receivers in this type of action; (2) that their claim was reduced to a judgment or admitted by the debtor in writing; (3) that the defendant corporation was insolvent; and (4) that all other legal and equitable remedies were inadequate. 641 S.W.2d at 939.

246. 641 S.W.2d 941 (Tex. App.—Dallas 1982, no writ).

247. *Id.* at 943.

248. 643 S.W.2d 519 (Tex. App.—Houston [14th Dist.] 1982), *aff'd*, 27 Tex. Sup. Ct. J. 162 (Jan. 14, 1984).

example. A closely held corporation was dissolved without giving creditors notice as required by the Texas Business Corporation Act.<sup>249</sup> Worse, substantial assets were paid over to the shareholders without any effort to first satisfy creditors and without keeping track of who had been paid and who had not. The last sentence of paragraph 8 of article 1302—2.07 of the Texas Miscellaneous Corporation Laws Act provides:

In the exercise of such powers [relating to the administration of the dissolved corporation's assets], the directors and officers shall be trustees for the benefit of creditors, shareholders, members, or other distributees of the corporation and shall be jointly and severally liable to such persons to the extent of the corporate property and assets that shall have come into their hands.<sup>250</sup>

It appeared, however, that one of the directors had successfully established that she had already paid \$26,000 out of her personal funds to corporate creditors (other than the plaintiff) in satisfaction of their claims, an amount that was greater than the \$20,000 of total assets received by all the shareholders from the corporation when it was dissolved. On the basis of this showing, the court held that the defendant was not liable for the claim of the present creditor since all the assets that she had held as trustee had been exhausted.<sup>251</sup> The court also refused to "disregard the corporate entity" and hold the defendant personally liable on that ground.<sup>252</sup> While the result reached has an air of plausibility about it, it seems to be erroneous since the defendant had a fiduciary duty not to prefer some creditors over others, and she had plainly not fulfilled that duty. In other words, the plaintiff appeared to be entitled to a pro rata portion of the \$20,000 of assets, which the court's opinion failed to recognize. The Texas Supreme Court has affirmed the decision of the court of appeals in the case.<sup>253</sup>

In *Speier Tire Co. v. Tom Benson Chevway Rental & Leasing Inc.*<sup>254</sup> the

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249. TEX. BUS. CORP. ACT ANN. art. 6.04, § A(2) (Vernon 1980) provides: "The corporation shall cause written notice by registered mail of its intention to dissolve to be mailed to each known creditor of and claimant against the corporation."

250. TEX. REV. CIV. STAT. ANN. art. 1302—2.07B (Vernon 1980).

251. 643 S.W.2d at 521. The appellate court thus reversed the trial court, which had held that the defendant was liable with two other directors for the debt owed the plaintiff. *Id.* at 520.

252. *Id.* at 520.

253. 663 S.W.2d 824 (Tex. 1984). The Texas Supreme Court held that the trust fund doctrine only requires distribution of total corporate assets to creditors, and that neither the Texas corporation statutes or the trust fund doctrine mandates that the directors apply limited corporate assets proportionally to corporate debts. *Id.* at 826-27. Two justices dissented, arguing persuasively that this result was not compelled by statute and had the clearly undesirable practical consequence of encouraging directors to favor certain creditors over other creditors when the assets were not sufficient to pay all creditors in full. *Id.* at 828-30 (Ray, J., dissenting). Such favoritism may be based on side payments to the directors or simply a desire to curry favor with certain creditors. It is possible under the supreme court's majority opinion that the disfavored creditor may have a direct cause of action against the favored creditor. The most likely consequence, however, of the supreme court's unfortunate decision is to increase the business of the already overburdened federal bankruptcy courts, since many preferential payments encouraged by the supreme court's decision may be voided as preferences under the Bankruptcy Code.

254. 643 S.W.2d 772 (Tex. App.—San Antonio 1982, writ ref'd n.r.e.).

court recognized that the revival of the charter and right to do business of a corporation, which had been forfeited for nonpayment of taxes, permits the corporation to proceed with a suit commenced before the revocation.<sup>255</sup> This result seems clearly to be contemplated by the statute.<sup>256</sup>

### I. Jurisdiction and Venue

In *Siskind v. Villa Foundation*<sup>257</sup> the Texas Supreme Court upheld the exercise of jurisdiction under article 2031b<sup>258</sup> over an Arizona school that actively advertised for students within the State of Texas through periodicals such as National Geographic and Sunset Magazine.<sup>259</sup> In addition, the school sent application forms and detailed information through the mails to a Texas resident as well as telephoning him. The court stated that the quantity of Villa's contacts with Texas may be truly minimal, while the qualities of these contacts are substantial.<sup>260</sup>

In *Hydrokinetics, Inc. v. Alaska Mechanical, Inc.*<sup>261</sup> the Fifth Circuit held that an Alaskan corporation was not amenable to suit in Texas where its only contact was the purchase of "waste heat recovery silencer units" from a Texas corporation that were delivered by the seller in Seattle, Washington. Negotiations preceding the contract were entered into by telex, telephone, and letter between the defendant in Alaska and the plaintiff in Texas; the only direct contacts by the defendant with Texas were the visit of two officers of the defendant to inspect the plaintiff's equipment and facilities, the acceptance of the defendant's offer to purchase by the plaintiff in Texas, and payment for the units by checks mailed from Alaska. The contract stated that it was to be controlled by Alaskan law. After reviewing the Fifth Circuit precedents, the court concluded that the contacts of the defendant were not sufficient to hold that the plaintiff had "purposefully availed itself of the privilege of conducting business within Texas or invoked the benefits and protections of Texas law."<sup>262</sup> Judge Tate dissented.

The major development with regard to venue is the enactment of a new venue statute in 1983.<sup>263</sup> In *Campbell & Son Construction Co. v. Housing Authority*<sup>264</sup> the plaintiff unsuccessfully sought to obtain venue over a corporate defendant on the theory that another corporation (as to which

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255. *Id.* at 773.

256. See TEX. TAX.-GEN. ANN. art. 12.17(3) (Vernon Supp. 1980) (current version at TEX. TAX CODE ANN. §§ 171.305-.308, .312-.315 (Vernon 1982)).

257. 642 S.W.2d 434 (Tex. 1982).

258. TEX. REV. CIV. STAT. ANN. art. 2031b (Vernon 1964).

259. The school was an Arizona corporation. The court affirmed the appellate court's dismissal of a suit against employees of the school, on the basis that the plaintiff alleged no specific acts by the employees occurring in Texas. The plaintiff, therefore, could not sue nonresident employees of a foreign corporation in a Texas court. 642 S.W.2d at 438.

260. *Id.* at 437.

261. 700 F.2d 1026 (5th Cir. 1983).

262. *Id.* at 1029.

263. TEX. REV. CIV. STAT. ANN. art. 1995 (Vernon Pam. Supp. 1964-1983). For a brief discussion of this statute, see *supra* notes 135-38 and accompanying text.

264. 655 S.W.2d 271 (Tex. App.—Corpus Christi 1983, no writ).

venue was admittedly proper) was the alter ego of the defendant. Not surprisingly, the court appeared to be unsympathetic to this novel use of the alter ego doctrine and limited its refusal to pierce the corporate veil to the issue of venue.<sup>265</sup>

In *W.T. Grinding & Supply v. Price Industries, Inc.*<sup>266</sup> the court held that a cause of action for breach of warranty of tools arose in the county where both parties knew that the tools were to be used by plaintiff, and venue was therefore proper in that state.<sup>267</sup> In *TXO Production Corp. v. Prickette*<sup>268</sup> a cause of action for breach of contract was held to arise in the county where the contract was made.

### J. Securities Regulation

A number of important issues were considered during the survey period by the state and federal courts and by the administrative agencies. In addition, the Texas Legislature made significant changes in the structure of the Texas Securities Board through the device of "sunset review."<sup>269</sup> At the federal level, the Securities and Exchange Commission adopted relatively minor amendments to its shareholder proposal regulations,<sup>270</sup> to the regulations relating to the manner in which registrants communicate with beneficial owners of shares held by nominees,<sup>271</sup> and to the regulations relating to disclosure of executive compensation.<sup>272</sup> In addition, it made permanent its "shelf registration" regulations with some modifications.<sup>273</sup> The Commission also received a widely watched report from an advisory committee on tender offers,<sup>274</sup> and is currently considering how to respond to the committee's numerous proposals for change. The Commission also proposed further simplification of rule 145, relating to disposal of restricted stock, by proposing essentially a uniform three-year holding period for all shares.<sup>275</sup>

The Supreme Court of the United States decided two important securities cases during the survey period. In *Herman & MacLean v. Huddleston*<sup>276</sup> the court held that the express remedies provided by sections 11 and 12(2) of the Securities Act of 1933 do not foreclose a remedy under rule 10b-5 for the same conduct.<sup>277</sup> The Fifth Circuit thereafter extended the reach of this decision to include the express remedy of section 9 of the

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265. *Id.* at 276.

266. 647 S.W.2d 89 (Tex. App.—Waco 1983, no writ).

267. *Id.* at 90.

268. 653 S.W.2d 642, 646 (Tex. App.—Waco 1983, no writ).

269. Act of Sept. 1, 1983, ch. 465, § 2, 1983 Tex. Gen. Laws 2692.

270. Sec. Rel. 34-20091, 48 Fed. Reg. 38,218-223 (adopted Aug. 16, 1983).

271. Sec. Rel. 34-20021, 48 Fed. Reg. 35,082 (adopted July 28, 1983).

272. Sec. Rel. 34-20220, 48 Fed. Reg. 44,467 (adopted Aug. 23, 1983).

273. Sec. Rel. 33-6499, 48 Fed. Reg. 52,889 (adopted Nov. 17, 1983).

274. SEC Advisory Comm. on Tender Offers, Report of Recommendations (July 8, 1983).

275. Sec. Rel. 33-6487, 48 Fed. Reg. 44,843 (proposed Sept. 23, 1983).

276. 103 S. Ct. 683, 74 L. Ed. 2d 548 (1982).

277. *Id.* at 690, 74 L. Ed. 2d at 559; see 15 U.S.C. §§ 77k, 77l(2) (1982).

Securities Exchange Act of 1934, over the dissent of Judge Gee.<sup>278</sup>

The second significant case was a major insider trading case, *Dirks v. Securities & Exchange Commission*.<sup>279</sup> In holding that a tippee did not violate the insider trading prohibitions of rule 10b-5 in the absence of some duty to the issuer, the Supreme Court appears to have plunged the entire area of tippee liability under that rule into uncertainty.<sup>280</sup> Only time and continued litigation will delineate the precise scope of this newly limited duty.

The major events at the Texas Securities Board during the survey period stemmed from its first review by the Sunset Commission. As a result of that review, the legislature adopted a number of housekeeping, public disclosure, and related amendments to the Securities Act.<sup>281</sup> Persons dealing with the board should routinely examine the amendments adopted in 1983, which mandate considerably greater disclosure than heretofore required on many matters within the board's area of regulation. The legislature added disqualifications for appointment and grounds for removal, and mandated annual reports to the legislature and the governor. Also, the legislature provided for further public disclosure of procedures and activities by the board, and subjected the board to the open meetings law. In addition, the administrative provisions of the Act were brought into conformity with the Texas Administrative Procedure Act,<sup>282</sup> and review was expressly made subject to the substantial evidence rule. Changes were also made in the penal provisions of the Act and the remedy of restitution to the victim of a fraudulent practice was expressly provided for.<sup>283</sup> Largely hortatory provisions were added encouraging the board to maximize coordination with federal and other states' securities laws while assuring protection to investors and minimizing regulatory burdens.<sup>284</sup> The commissioner was given express power to waive or relax provision in the board's rules that are unnecessary for the protection of investors.<sup>285</sup>

Litigation in the state courts under the Texas securities law involved relatively minor issues. In *Weaver v. State*,<sup>286</sup> for example, the defendant

278. *Chemerton Corp. v. Business Funds, Inc.*, 718 F.2d 725 (5th Cir. 1983); see 15 U.S.C. § 78i (1982).

279. 103 S. Ct. 3255, 77 L. Ed. 2d 911 (1983).

280. The court stated:

[A] tippee assumes a fiduciary duty to the shareholders of a corporation not to trade on material nonpublic information only when the insider has breached his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows or should know that there has been a breach.

*Id.* at 3264, 77 L. Ed. 2d at 925.

281. Act of Sept. 1, 1983, ch. 465, §§ 1-9, 1983 Tex. Gen. Laws 2688 (amending TEX. REV. CIV. STAT. ANN. arts. 581-1 to -32).

282. TEX. REV. CIV. STAT. ANN. art. 581-14 (Vernon Supp. 1984).

283. *Id.* art. 581-32.

284. *Id.* art. 581-28-1.

285. *Id.* art. 581-10, § D.

286. 652 S.W.2d 420, 424 (Tex. App.—Houston [1st Dist.] 1982, no pet.). The court first reversed the conviction on the ground that the indictment did not allege that disclosure of the undisclosed fact was necessary to make other statements not misleading under TEX. REV. CIV. STAT. ANN. art. 581-29, § C(3) (Vernon Supp. 1984). On rehearing, however, the

received a seven-year prison sentence plus a \$5,000 fine for violation of this statute. The defendant in *Hawkins v. State*<sup>287</sup> was more fortunate: he received four years, probated, for failing to disclose that a colleague had been previously convicted of a securities violation and for stating that the investor's funds would be used exclusively in mining operations, when in fact only \$850 out of a total investment of \$2500 would be used for that purpose.<sup>288</sup>

Finally, in a favorable opinion for attorneys, a Texas court of appeals reaffirmed the position that an attorney is liable for negligence only to his client.<sup>289</sup> The attorney owes no duty to third parties in the absence of privity of contract even if the third party directly and knowingly relies on the attorney's opinion.<sup>290</sup> The case involved an opinion by counsel for a computer software firm that a transaction between it and a county was binding on the county. The plaintiff then advanced funds to the computer firm, taking an assignment of the computer firm's rights to receive payment on the contract. The attorney knew of the purpose of the opinion; indeed, the plaintiff provided the language to be inserted in the opinion. It was determined later that the county had not validly entered into the contract and therefore was not bound by it. The court also considered arguments that the attorney, by issuing his opinion, aided and assisted in a sale of a security in violation of the Texas Securities Act,<sup>291</sup> and that the attorney made a false and fraudulent representation in connection with the sale of a security,<sup>292</sup> but concluded that the transaction did not involve a "security."<sup>293</sup>

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court concluded that the conviction could be upheld under *id.* art. 581—29, § C(1) which prohibits engaging in any fraud or fraudulent practice.

287. 656 S.W.2d 70 (Tex. Crim. App. 1983).

288. *Id.* at 73.

289. *First Mun. Leasing Corp. v. Blankenship, Potts, Aikman, Hagin & Stewart*, 648 S.W.2d 410, 413 (Tex. App.—Dallas 1983, writ ref'd n.r.e.). The court noted the strong trend toward adoption of a more liberal view in other jurisdictions, but declined to follow that trend. *Id.* at 413. The court also rested its decision on the alternative ground that the third person did not rely on the attorney's opinion. *Id.* at 414.

290. *Id.* at 413.

291. TEX. REV. CIV. STAT. ANN. art. 581—4 (Vernon 1964 & Supp. 1984).

292. *Id.* art. 581—33 (Vernon Supp. 1984).

293. 648 S.W.2d at 416.

