



January 1973

Corporations

J. Leon Lebowitz

Recommended Citation

J. Leon Lebowitz, *Corporations*, 27 SW L.J. 85 (1973)
<https://scholar.smu.edu/smulr/vol27/iss1/8>

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

CORPORATIONS

by

J. Leon Lebowitz*

BECAUSE the legislature did not meet in regular session during the survey period, the developments of significance that occurred in Texas' corporation laws came from judicial decisions. There were a number of cases which dealt with interesting aspects of corporation law. The most important was a decision by the Texas Supreme Court reinstating stock transfer restrictions to full vigor after the validity of some restrictions permitted by the Texas Business Corporation Act (TBCA) had been erroneously questioned in the lower courts.¹ There were no changes in, or new administrative interpretations of, the Texas Securities Act, and only two cases dealing with the Act were reported.² The State Securities Board had a busy year, however, registering a record 1.569 billion dollars in securities and processing over 1,912 applications to register, a thirty-two percent increase over the number recorded in the preceding fiscal year.³

I. THE CORPORATION AS AN ENTITY: REGARD AND DISREGARD

An interesting phenomenon in the development of the Texas case law on corporations is the continuing recurrence of decisions in which the courts are asked to analyze the elusive nature of a corporation by litigants seeking either to interpose or disregard the existence of a corporation, depending on which best fits their cause or defense. Somehow, these cases seem to be more abundant than almost any other kind in the corporate field.⁴ The reasons are fairly obvious, but have been extensively explored elsewhere.⁵ Certainly, the current survey period showed no diminution in the pattern.

One of the ploys a corporate creditor may use when attempting to hold an individual shareholder personally liable for corporate obligations is to contend that the corporation is no more than the shareholder's alter ego. The term conceals more than it reveals, and it is often used as a shorthand justification for imposing liability on shareholders who commingle their own and their corporation's business affairs.⁶ The alter ego terminology frequently crops up in one-man corporation situations.⁷ But when the corporation has several

* B.A., J.D., Baylor University; LL.M., New York University. Professor of Law, University of Texas at Austin.

¹ *Ling & Co. v. Trinity Sav. & Loan Ass'n*, 482 S.W.2d 841 (Tex. 1972), *rev'g* 470 S.W.2d 441 (Tex. Civ. App.—Waco 1971); see notes 68-92 *infra*, and accompanying text.

² See notes 146-73 *infra*, and accompanying text.

³ TEX. MONTHLY SECURITIES BULL., Aug. 1972, at 1. Of the dollar amount registered, 272 million dollars represented original applications for the sale of securities by Texas corporations. *Id.* at 15.

⁴ See Amsler, *Corporations, Annual Survey of Texas Law*, 22 Sw. L.J. 59, 71 (1968); Amsler, *Corporations, Annual Survey of Texas Law*, 23 Sw. L.J. 98, 100 (1969); Hamilton & Shields, *Corporations, Annual Survey of Texas Law*, 25 Sw. L.J. 88 (1971); Lebowitz, *Corporations, Annual Survey of Texas Law*, 26 Sw. L.J. 86, 143 (1972); Pelletier, *Corporations, Annual Survey of Texas Law*, 21 Sw. L.J. 134, 149 (1967).

⁵ Hamilton, *The Corporate Entity*, 49 TEXAS L. REV. 979 (1971). For a more cursory analysis of the disregard problem, see Lebowitz, *supra* note 4, at 142-53; Pelletier, *supra* note 4, at 141-50.

⁶ See Hamilton, *supra* note 5, at 990. See generally N. LATTIN, *LAW OF CORPORATIONS* 86 (2d ed. 1971).

⁷ See, e.g., *Ragland v. Curtis Mathes Sales Co.*, 446 S.W.2d 577 (Tex. Civ. App.—Waco

shareholders, it becomes more difficult to invoke the doctrine, especially when the defendant whose personal liability is sought owns even less stock than the complaining shareholder.

In *Mills v. Withers*⁸ the plaintiff, who owned twenty-seven percent of a corporation's outstanding stock, brought a derivative action against a seven percent shareholder, claiming the latter and the deceased majority shareholder had cosigned checks which had been used to pay personal debts and obligations of an affiliated corporation. Alternatively, he alleged that the corporation "existed as a shadow of the personality" of the defendant, and asked for an individual recovery from him of \$3,000, the amount the plaintiff had invested in the business. In remanding the case for improper submission of issues, the court upheld most of the expenditures as having been made for corporate purposes, although there was some evidence the corporation may have been paying more than its share of expenses for offices it shared with the majority shareholder and two affiliated corporations. As to the alter ego argument, the court could find no basis for it under the facts presented. The defendant was not an officer and held only a small percentage of the stock; the business had been conducted largely by the majority shareholder; and while the balance of the stock was owned by the defendant's friends and business associates, there was no evidence he controlled or dominated them.

The plaintiffs were more successful in another alter ego case, however. In *Wright Hydraulics, Inc. v. Womack Machine Supply Co.*⁹ two affiliated corporations, one in Dallas and the other in Houston, obtained injunctive relief not only restraining former employees from breaching anti-competitive restrictive covenants and improperly using customers' names and credit information obtained while still in the plaintiffs' employ, but also restraining a corporation, which the former employees had organized after leaving their employment with the plaintiffs, from the same practices. The court found the corporation was a device or alter ego which the former employees used to breach their express or implied covenants not to compete or misuse confidential information. But at the same time, the plaintiff corporations were not allowed to disregard their own separate identities for their mutual benefit so as to preclude competition in both their trade territories by former employees of either. Therefore, the court modified the scope of the agreed restrictions so that former employees of the Dallas firm would not be enjoined from engaging in a similar business outside its trade area even though they might be in competition with the Houston firm which the Dallas affiliate would wish to protect, and vice versa. Moreover, the duration of the non-competitive restriction within one of the former employer's trade area would be measured from the time an employee left that employment, and not from the date he severed his employment relations with the other employer, despite the latter's status as a subsidiary or affiliate of the former.

One-Man Corporations. Despite the possible hazards of disregard, the in-
1969); American Petroleum Exch., Inc. v. Lord, 399 S.W.2d 213 (Tex. Civ. App.—Fort
Worth 1966), error ref. n.r.e.

⁸ 483 S.W.2d 339 (Tex. Civ. App.—Houston [1st Dist.] 1972).

⁹ 482 S.W.2d 34 (Tex. Civ. App.—Fort Worth 1972).

corporated proprietorship is an established economic fact of life¹⁰ and undoubtedly comprises a considerable percentage of the corporations formed in this state each year.¹¹ (It is time, therefore, for Texas to dispense with the ritual of requiring three incorporators.)¹² Yet with the pleasures of limited liability which the erstwhile proprietor gains, he needs an occasional reminder that that which was formerly his now belongs to another, albeit artificial, entity, with consequences he may not necessarily appreciate. Two recent cases make the point.

In the first case,¹³ the plaintiff, a sole shareholder, purchased an employment agency franchise, paying for it with a check drawn on his corporation out of proceeds of the sale of another franchise owned by the corporation. When the plaintiff discovered that the earnings of the employment agency had been misrepresented, he sued for rescission in his individual capacity. Reversing a judgment in his behalf, the Austin court of civil appeals ruled that the corporation should have been joined as a party plaintiff. Though the plaintiff owned all the stock, the employment agency belonged to the corporation.¹⁴ Corporate assets having been used to acquire the property, the corporation was the proper party to regain those assets for the benefit of its creditors. Even a sole shareholder cannot bring an action individually on behalf of his corporation.¹⁵ Late in the survey period, however, the supreme court reversed the Austin court because in its view there was no evidence to show the corporation was an indispensable party.¹⁶ It was not a party to the agreement and any right it had rested wholly on the supposition, based on evidence, that it furnished the money for the purchase and was wholly owned. Interestingly, the court then proceeded to do some supposing of its own, conjecturing that the corporation furnished the money because it may have already

¹⁰ Of the estimated 12,010,000 businesses in the United States, some 9,430,000 are proprietorships, 921,000 are partnerships, and 1,659,000 are corporations. U.S. BUREAU OF THE CENSUS, STATISTICAL ABSTRACT OF THE UNITED STATES 470 (93d ed. 1972).

¹¹ See Bailey, *Need for Revision of the Texas Corporation Statutes*, 3 BAYLOR L. REV. 1, 2 (1950).

¹² Although the use of three incorporators has been a standard requirement in American corporate legislation for many years, the trend is toward permitting a single incorporator. H. HENN, HANDBOOK OF THE LAW OF CORPORATIONS 220 (2d ed. 1970). In 1962 the Model Business Corporation Act was amended to provide that "[o]ne or more persons, or a domestic or foreign corporation, may act as incorporator or incorporators . . ." 2 ABA MODEL BUS. CORP. ACT ANN. § 53, at 160 (2d ed. 1971). By 1970, 30 states had similar provisions. *Id.* at 162. Although a number of amendments to the TBCA for enactment in 1973 have been proposed by the Committee on Revision of Corporation Law of the State Bar Section on Corporation, Banking and Business Law which reflect similar amendments to the Model Act, see Kerr, *Proposed Amendments to Corporation Laws*, 35 TEX. B.J. 1133 (1972), the reduction of the number of incorporators from three to one was not included.

¹³ *Evens-Personnel Consultants, Inc. No. One v. Heinrichs*, 477 S.W.2d 413 (Tex. Civ. App.—Austin), *rev'd*, 486 S.W.2d 935 (Tex. 1972).

¹⁴ The title to corporate assets is vested in the corporation, not the shareholders. *Moroney v. Moroney*, 286 S.W. 167, 169 (Tex. Comm'n App. 1926), *judgment adopted*; *Calvert v. Capital Southwest Corp.*, 441 S.W.2d 247, 263 (Tex. Civ. App.—Austin 1969), *error ref. n.r.e., appeal dismissed*, 397 U.S. 321 (1970). Sometimes, however, a conveyance by the sole or all the shareholders may be sufficient to pass title to corporate property. See, e.g., *Aransas Pass Harbor Co. v. Manning*, 94 Tex. 558, 63 S.W. 627 (1901); *Anderson v. King*, 370 S.W.2d 775 (Tex. Civ. App.—Texarkana 1963).

¹⁵ See, e.g., *Schaffer v. Universal Rundle Corp.*, 397 F.2d 893, 896 (5th Cir. 1968); *Massachusetts v. Davis*, 140 Tex. 398, 407, 168 S.W.2d 216, 221 (1943); *First State Bank v. Bolinger*, 431 S.W.2d 782, 784 (Tex. Civ. App.—Fort Worth 1968), *error ref. n.r.e.*

¹⁶ 486 S.W.2d 935 (Tex. 1972).

owed that amount to the sole shareholder or may have advanced the sum as a loan. Admittedly, the corporation's role was not adequately developed in the case, but a proper regard for its separate existence and property rights should have resulted in a remand to determine that issue.

In the second case¹⁷ Graham, who was president and apparently the sole owner of his corporation, brought a trial of right of property proceeding to recover personal property he claimed was his from being levied upon to satisfy a judgment against his corporation. He was unsuccessful, however, when the record showed the property had been used in the corporate business; he had told employees it was corporate property; he had mortgaged the property along with corporate realty to secure corporate debts; the property was listed on the corporation's depreciation tables; and, most damaging of all, when earlier executions were levied against him personally, he claimed he owned no property. The result seems just; almost poetically so.

Parent-Subsidiary Relationship. The temptation to disregard formal corporate barriers and consider a business enterprise as a whole may also occur in larger economic undertakings where, for purposes of convenience or to facilitate corporate growth, business is conducted through a number of controlled entities.¹⁸ Here, too, those who choose to do business through multi-corporate devices may find they have to pay the price. For example, in *English v. Ramo, Inc.*¹⁹ a parent corporation that caused its subsidiary to make large advances to it was deemed to have actually received dividends from the subsidiary contrary to the terms of a purchase agreement securing payment of notes given the subsidiary's former owners, in spite of testimony by the president of the parent, the subsidiary, and of TeleCom Corporation, a holding company owning eighty-nine percent of the parent's stock, that the three companies were all part of TeleCom and were "just like one company."²⁰ In his view, since the advances were not an indebtedness owed to outside interests, their repayment was an inter-company matter for management to decide in the best interests of TeleCom's shareholders. The court's response was that the subsidiary's stock was not the absolute property of the parent but had been pledged to secure the notes given to the sellers. Any distribution of funds to the controlling stockholder because of its stock ownership and for its sole benefit, repayable at its discretion, would be deemed a dividend insofar as the rights of creditors were concerned.

In another case, *Silco, Inc. v. Calvert*,²¹ an ingenious effort by a parent to

¹⁷ *Graham v. Thomas D. Murphy Co.*, 474 S.W.2d 251 (Tex. Civ. App.—Eastland 1971), *error ref. n.r.e.*

¹⁸ See Hamilton, *supra* note 5, at 992; Note, *Corporations—Piercing the Corporate Veil*, 23 SW. L.J. 384 (1969). See generally H. HENN, *supra* note 12, at 258; N. LATTIN, *supra* note 6, at 100; Ballantine, *Separate Entity of Parent and Subsidiary Corporations*, 14 CALIF. L. REV. 12 (1925); Cataldo, *Limited Liability with One-Man Companies and Subsidiary Corporations*, 18 LAW & CONTEMP. PROB. 473 (1953); Douglas & Shanks, *Insulation from Liability Through Subsidiary Corporations*, 39 YALE L.J. 193 (1929); Annot., 38 A.L.R.3d 1102 (1971) (liability of corporation for contracts of subsidiary).

¹⁹ 474 S.W.2d 600 (Tex. Civ. App.—Dallas 1971), *error granted*.

²⁰ *Id.* at 604.

²¹ 482 S.W.2d 56 (Tex. Civ. App.—Austin 1972), *error ref. n.r.e.*

avoid payment of the Texas franchise tax²² because none of its four subsidiaries had to pay the tax was blocked by the same separate entity obstacle. Silco was a holding company that owned a state bank, two insurance companies, and a state-chartered savings and loan company, each exempt from Texas franchise taxation.²³ Having received large cash dividends from its state bank, Silco argued it should not have to pay the tax since both logic and equity dictated that substance and not form should prevail. Therefore, the exemptions of each of the subsidiaries should extend to the parent. The Austin court of civil appeals was not persuaded. Each of the corporations, it said, was, under the law, a separate legal entity. The fact that a company invests part of its capital in the stock of exempt companies does not entitle it to an exemption, especially since exemptions from the tax must be strictly construed.²⁴ Moreover, the state bank dividends would have to be treated as part of Silco's gross receipts from business done in Texas, even though the comptroller of public accounts had ruled dividends from national banks may be excluded.²⁵ Despite the provision of the Texas Banking Code which directs that state and national banks be treated alike for purposes of regulation and taxation to the extent Texas has power to so legislate,²⁶ the mandate for equal treatment does not apply to corporations such as Silco, which are not themselves banks.

Pleading that corporation *B* is a division of corporation *A* or that *A* does business under the name of *B* will not support a summary judgment against *A* when *A* denies under oath that *B* is its division or that it does business under that name. The case so holding²⁷ was an action on an account made out to *B*; by virtue of its denial, *A* stood as a stranger to the transaction, and a triable issue of fact was created with respect to its relationship to *B*.

On the other hand, in *Bland v. Kentucky Fried Chicken Corp.*²⁸ a federal district court found that a parent corporation, Kentucky Fried Chicken (KFC), exercised so much control over a ninety-five percent owned subsidiary, Colonel Sanders' Inn, Inc. (CSI), in the making of a contract between the plaintiff, a Texas resident, and CSI for the purchase of plaintiff's motel in exchange for KFC stock, that KFC would be deemed a party to the contract, and, thus, doing business in Texas within the meaning of the Texas long-arm statute.²⁹ The plaintiff had sued both KFC and CSI in state court for breach of the contract, serving KFC by substituted service on the secretary of state. Upon re-

²² TEX. REV. CIV. STAT. ANN. tit. 122A, arts. 12.01-22 (1969).

²³ Insurance companies and state-chartered savings and loan associations are exempt from franchise taxation by *id.* art. 12.03 (Supp. 1972). State banks are exempted under an administrative interpretation of the Comptroller of Public Accounts to provide equal treatment with national banks which are deemed exempt from the tax. Letter from Comptroller of Public Accounts, Feb. 7, 1964, CCH TEX. TAX REP. ¶ 5.203B. *But cf.* 12 U.S.C. § 548 (1970), which provides: "For the purpose of any tax law enacted under the authority of the United States or any State, a national bank shall be treated as a bank organized and existing under the laws of the State or other jurisdiction within which its principal office is located."

²⁴ *See, e.g.,* McCallum v. Associated Retail Credit Men, 41 S.W.2d 45 (Tex. Comm'n App. 1931), judgment adopted.

²⁵ 482 S.W.2d at 58.

²⁶ TEX. REV. CIV. STAT. ANN. art. 342-908 (Supp. 1972).

²⁷ Compression, Inc. v. James, 481 S.W.2d 458 (Tex. Civ. App.—Houston [1st Dist.] 1972).

²⁸ 338 F. Supp. 871 (S.D. Tex. 1971).

²⁹ TEX. REV. CIV. STAT. ANN. art. 2031b (1964).

moval to federal court, KFC moved to dismiss for lack of personal jurisdiction. There was evidence KFC had some commercial contacts with Texas in its relations with its Texas franchises. But because the plaintiff's cause of action had nothing to do with KFC's franchise business, the court declined to subject it to jurisdiction on a non-related claim in the absence of a Texas case so holding.³⁰

Nevertheless, the court overruled KFC's motion because of the parent-subsubsidiary relationship. KFC's control over CSI appeared so great that the plaintiff was able to make a prima facie showing that KFC had in reality entered into the contract in Texas through its subsidiary and consequently became subject to the jurisdiction of the court. The court noted that KFC listed CSI as an asset in its consolidated stockholder statement, could name three of its five directors, furnished it with capital and management, and provided it with KFC stock to be used in acquiring motels from third parties. In short, it established an agent corporation to use KFC's Colonel Sanders image in the exploitation of the motel market to KFC's benefit.³¹ More specifically, the facts showed that while KFC was not a formal party to the contract, it had a substantial hand in its formulation and all the parties contemplated it would play a major role in carrying it out, including, under certain conditions, registering the KFC stock given plaintiff for public sale. As a consequence, KFC had conducted business in Texas of sufficient quality and nature to satisfy the minimum contacts standard.³²

The decision is a troubling one. On the facts given, the relationship between KFC and CSI would appear to be no different than might be expected in a ninety-five percent control situation. Generally, mere ownership and control of a domestic subsidiary which is subject to the jurisdiction of a state's courts does not give the state courts jurisdiction over a foreign corporation parent which otherwise does not do business in the state, if the formal barriers between the two entities have been maintained.³³ On the other hand, if

³⁰ The court suggested Texas could constitutionally exercise jurisdiction over nonresident persons or corporations conducting business in the state even though the claim has no relation to their Texas operations. For example, jurisdiction might be sustained if Texas decided it needed to control an industry such as franchising whose burgeoning operations and intricate relations with Texas residents have had a substantial impact on the local economy. 338 F. Supp. at 875. The extent to which business activities must be carried on in the state to constitute a generally affiliating basis for jurisdiction with respect to a claim arising outside the forum has not been fully resolved. The *Restatement of Conflicts* takes the position that such jurisdiction can be exercised if the foreign corporation's business within the state is so continuous and substantial as to make it reasonable for the state to exercise such jurisdiction. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 47(2) (1971). The leading case so holding is *Perkins v. Benguet Consol. Mining Co.*, 342 U.S. 437 (1952). See generally A. EHRENZWEIG, TREATISE ON THE CONFLICT OF LAWS 114 (1962); F. JAMES, CIVIL PROCEDURE 640 (1965); G. STUMBERG, PRINCIPLES OF CONFLICT OF LAWS 95 (3d ed. 1963); R. WEINTRAUB, COMMENTARY ON THE CONFLICT OF LAWS 107 (1971); von Mehren & Trautman, *Jurisdiction To Adjudicate: A Suggested Analysis*, 79 HARV. L. REV. 1121, 1141 (1966).

³¹ 338 F. Supp. at 876.

³² *International Shoe Co. v. Washington*, 326 U.S. 310, 320 (1945); see note 219 *infra*, and accompanying text.

³³ The leading case so holding is *Cannon Mfg. Co. v. Cudahy Packing Co.*, 267 U.S. 33 (1925). See generally RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 52, comment *b* at 180 (1971); R. WEINTRAUB, *supra* note 30, at 136; *Developments in the Law—State-Court Jurisdiction*, 73 HARV. L. REV. 909, 932 (1960); Annot., 18 A.L.R.2d 187, 193 (1951) (ownership or control by foreign corporation of stock of other corporation as constituting doing business within state).

formal separateness has not been observed,³⁴ or the affairs of the subsidiary were so dominated or manipulated that the relationship becomes a sham operating to the detriment of creditors, or others,³⁵ or the subsidiary acted as the parent's agent in the transaction underlying the litigation,³⁶ then jurisdiction can be asserted against the parent.³⁷ In *Bland* the facts given did not indicate that CSI failed to function formally as a separate corporation, had its affairs manipulated, or was simply a sham or dummy through which KFC operated in Texas. The agency argument seems to be the most plausible, yet the plaintiff chose to contract with the subsidiary alone, although the plaintiff knew full well who the purported principal was.³⁸ The court, too, must have been bothered by its holding, since it permitted an interlocutory appeal to be sought on the ground that its decision that, for jurisdictional purposes, KFC did business in Texas through its subsidiary, involved a controlling question of law as to which there was a substantial difference of opinion.³⁹

Successor Corporations. Two cases dealt with the legal effect of a corporation being formed as a legal continuation of a former business. In *Eagle Pass Realty Co. v. Esparza*,⁴⁰ a trespass to try title action, the land in question had been acquired by a corporation formed in 1910, but whose charter expired in 1920. Nevertheless, the stockholders apparently continued carrying on business under the corporate name, and in 1922 reincorporated under the same name for a fifty-year period. Because the Texas law at that time provided no basis for extending the duration of a corporation after its charter had expired⁴¹ and there was no conveyance of the property in question from the

³⁴ See, e.g., *Maas v. Orange Crush Co.*, 99 F.2d 675 (4th Cir. 1938); *United States v. Buffalo Weaving & Belting Co.*, 155 F. Supp. 454 (S.D.N.Y. 1956); *State ex rel. Grinnell Co. v. MacPherson*, 62 N.M. 308, 309 P.2d 981, cert. denied, 355 U.S. 825 (1957).

³⁵ See, e.g., *Frazier v. Alabama*, 349 F.2d 456 (5th Cir. 1965); *Costello v. Atlas Corp.*, 297 F. Supp. 19 (N.D. Cal. 1967); *Pergament v. Frazier*, 93 F. Supp. 9 (E.D. Mich. 1950); *Empire Steel Corp. v. Superior Court*, 56 Cal. 2d 823, 366 P.2d 502, 17 Cal. Rptr. 150 (1961).

³⁶ See, e.g., *Curtis Publishing Co. v. Cassel*, 302 F.2d 132 (10th Cir. 1962); *Tokyo Boeki (U.S.A.), Inc. v. S.S. Navarino*, 324 F. Supp. 361 (S.D.N.Y. 1971); *Luce & Co., S. en C. v. Alimentos Borinquenos, S.A.*, 283 F. Supp. 81 (D.P.R. 1968).

³⁷ See generally 18 W. FLETCHER, *CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS* 527 (perm. rev. ed. 1969); Foster, *Personal Jurisdiction Based on Local Causes of Action*, 1956 WIS. L. REV. 522, 563.

³⁸ Generally the Texas courts will not disregard the corporate entity for one who contracts with a corporation and not its sole or principal shareholder, even though he knows the corporation is undercapitalized or just a shell. See, e.g., *Bell Oil & Gas Co. v. Allied Chem. Corp.*, 431 S.W.2d 336 (Tex. 1968) *passim*; *Pace Corp. v. Jackson*, 155 Tex. 179, 284 S.W.2d 340 (1955); *Paine v. Carter*, 469 S.W.2d 822 (Tex. Civ. App.—Houston [14th Dist.] 1971), error ref. *n.r.e.*; *Atomic Fuel Extraction Co. v. Estate of Slick*, 386 S.W.2d 180 (Tex. Civ. App.—San Antonio 1964), error ref. *n.r.e.* See generally Hamilton, *supra* note 5, at 984; *Lebowitz*, *supra* note 4, at 146.

³⁹ 28 U.S.C. § 1292(b) (1970); see C. WRIGHT, *HANDBOOK OF THE LAW OF FEDERAL COURTS* 462 (2d ed. 1970). If an interlocutory appeal were taken, it had not been reported at the time of this writing.

⁴⁰ 474 S.W.2d 624 (Tex. Civ. App.—San Antonio 1971), error ref. *n.r.e.*

⁴¹ Prior to the adoption of the TBCA in 1955, a Texas corporation could only be chartered for a maximum period of 50 years. Ch. 140, § 1, [1929] Tex. Laws 303, repealed, Ch. 229, § 1, [1971] Tex. Laws 460. See 1 I. HILDEBRAND, *THE LAW OF TEXAS CORPORATIONS* 173 (1942). Under the TBCA a corporation may have perpetual succession. TEX. BUS. CORP. ACT ANN. arts. 2.02(A)(1), 3.02(A) (1956). If the corporation has chosen a fixed period for its duration it may, within the three-year period in which it has limited survival after its term of life expires, amend its articles of incorporation so as to extend or per-

first to the second corporation, the latter could not be said to own the property. Although upon dissolution the directors of the first corporation became the trustees of its assets for winding up purposes,⁴³ they had no power to form a new corporation or amend the articles of the expired corporation. The two corporations were distinct entities.

In *Brooks v. Eaton Yale & Towne, Inc.*⁴³ a creditor brought an action against partners for goods sold on an open account. One of the partners contended the partnership had been succeeded by a corporation which had become bankrupt, and that by filing a claim against the corporation in bankruptcy and accepting a dividend from the bankruptcy court, the creditor had made an election of remedies and could not now sue the partnership or partners. The court disagreed, finding no novation or election of remedies and noting that in filing its claim the creditor specifically reserved its rights against the predecessor partnership. The case is somewhat unusual in that it is usually the successor corporation of an existing business that is sought to be held liable for debts incurred before incorporation,⁴⁴ but the result certainly is in accord with general partnership and corporation law principles.

II. RIGHTS, DUTIES, AND LIABILITIES OF CORPORATE MANAGEMENT

General Liabilities of Directors and Officers. Those who manage corporations are fiduciaries and in that sense are responsible to their corporations and shareholders as a whole for acts that breach their duties of care and loyalty.⁴⁵ The TBCA imposes additional liabilities on directors with regard to certain fiscal and other matters.⁴⁶ Further liabilities may be incurred under other legislation.⁴⁷

Normally, management owes these duties and liabilities to the corporation either directly or derivatively, and not to third persons.⁴⁸ But if a director or

petuate its period of existence. *Id.* art. 7.12; TEX. REV. CIV. STAT. ANN. art. 1302-2.07 (1952).

⁴² Ch. 166, § 4, [1907] Tex. Laws 312; *cf.* TEX. REV. CIV. STAT. ANN. art. 1302-2.07 (1962).

⁴³ 474 S.W.2d 321 (Tex. Civ. App.—Waco 1971).

⁴⁴ *E.g.*, *Ryder Truck Rental, Inc. v. Ace Sales Co.*, 368 S.W.2d 869, 872 (Tex. Civ. App.—Austin 1963), *error ref. n.r.e.*; *Baca v. Weldon*, 230 S.W.2d 552, 556 (Tex. Civ. App.—San Antonio 1950), *error ref. n.r.e.*; *Religious Films v. Potts*, 197 S.W.2d 592, 594 (Tex. Civ. App.—Galveston 1946).

⁴⁵ *E.g.*, *B-M-G Inv. Co. v. Continental/Moss-Gordin, Inc.*, 320 F. Supp. 969, 972 (N.D. Tex. 1969); *International Bankers Life Ins. Co. v. Holloway*, 368 S.W.2d 567, 576 (Tex. 1963); *Independence Ins. Co. v. Republic Nat'l Life Ins. Co.*, 447 S.W.2d 462, 470 (Tex. Civ. App.—Dallas 1969), *error ref. n.r.e.* See generally H. HENN, *supra* note 12, at 450; 3 I. HILDEBRAND, *supra* note 41, at 1; 1 G. HORSTEIN, *CORPORATION LAW & PRACTICE* 528 (1959); W. KNEPPER, *LIABILITY OF CORPORATE OFFICERS AND DIRECTORS* 7 (1969); N. LATTIN, *supra* note 6, at 272, 282; Cary, *Corporate Standards and Legal Rules*, 50 CALIF. L. REV. 408 (1962); Lebowitz, *Director Misconduct and Shareholder Ratification in Texas*, 6 BAYLOR L. REV. 1 (1953); Marsh, *Are Directors Trustees? Conflict of Interest and Corporate Morality*, 22 BUS. LAW. 35 (1966); Neilsen, *Directors Duties Under Anglo-American Law*, 43 U. DET. L.J. 605 (1966); Comment, *The Interested Director in Texas*, 21 SW. L.J. 794 (1967).

⁴⁶ TEX. BUS. CORP. ACT ANN. arts. 2.04(B) (2), 2.41 (1956).

⁴⁷ See, *e.g.*, TEX. REV. CIV. STAT. ANN. arts. 1302-2.02 (incorporation without change of name; failure to publish statutory notice), 1302-2.07B (post-dissolution liability for corporate property and assets) (1962); TEX. REV. CIV. STAT. ANN. tit. 122A, art. 12.14 (1969) (liability for debts incurred after right to do business forfeited for nonpayment of franchise tax).

⁴⁸ *E.g.*, *Sutton v. Reagan & Gee*, 405 S.W.2d 828, 835 (Tex. Civ. App.—San Antonio

officer engages in a wrongful act that harms another, he may be held personally liable by the person harmed, although he was acting in behalf of and for the benefit of his corporation in the transaction.⁴⁹ This was the holding in *Penroc Oil Corp. v. Donahue*,⁵⁰ in which the court set aside a summary judgment that had been granted in favor of two officer-directors in an action seeking rescission against a corporation and damages against all its director-officers for fraud in a contract for sale of sulphur leases. Although the appellees claimed they signed the agreement in dispute in their official capacity only, the evidence showed they had knowledge of all the circumstances surrounding the sale and had participated actively in the overall transaction. Where fraud has been practiced, the directors or officers who authorize, direct, or make the wrongful misrepresentations will be held equally liable with their corporation for the tort. They can claim no exoneration because they acted as the corporation's representatives or agents in the matter.⁵¹

Presence or Absence of Corporate Formalities. The law prescribes the basic format by which corporations are governed, including requirements for proper call, quorum, and voting at directors' and shareholders' meetings; however, these norms basically are for the protection of the corporation's shareholders and seldom can be used as a shield to evade obligations to outsiders.⁵² Thus,

1966), *error ref. n.r.e.*; see W. CARY, *CASES AND MATERIALS ON CORPORATIONS* 865 (4th ed. 1969); 3 W. FLETCHER, *supra* note 37, at 199 (perm. ed. rev. repl. 1965); 1 G. HORNSTEIN, *supra* note 45, at 529; Pelletier, *supra* note 4, at 139.

⁴⁹ See, e.g., *A.H. Belo & Co. v. Fuller*, 84 Tex. 450, 452, 19 S.W. 616, 617 (1892) (dictum) (libel); *Western Rock Co. v. Davis*, 432 S.W.2d 555, 558 (Tex. Civ. App.—Fort Worth 1968) (blasting); *Sutton v. Reagan & Gee*, 405 S.W.2d 828, 833 (Tex. Civ. App.—San Antonio 1966), *error ref. n.r.e.* (conversion); *Peter v. First State Bank*, 92 S.W.2d 1079, 1082 (Tex. Civ. App.—Austin 1936) (dishonored draft); *Cameron v. First Nat'l Bank*, 194 S.W. 469, 477 (Tex. Civ. App.—Galveston 1917), *error ref.* (fraud); *Allen v. Hutcherson*, 121 S.W. 1141, 1144 (Tex. Civ. App. 1909) (misappropriation). See H. BALLANTINE, *CORPORATIONS* 275 (rev. ed. 1946); W. CARY, *supra* note 48, at 863; 3 W. FLETCHER, *supra* note 37, at 778; 3 I. HILDEBRAND, *supra* note 41, at 22.

⁵⁰ 476 S.W.2d 849 (Tex. Civ. App.—El Paso 1972), *error ref. n.r.e.*

⁵¹ See, e.g., *Cameron v. First Nat'l Bank*, 194 S.W. 469, 477 (Tex. Civ. App.—Galveston 1917), *error ref.*; *Allen v. Hutcherson*, 121 S.W. 1141, 1144 (Tex. Civ. App. 1909), *error ref.* (dictum). But directors and officers are not liable simply because of their office for fraudulent or false misrepresentations of other officers or agents, or for fraud attributable to the corporation itself if they were not personally connected with the wrong and did not participate in it. *K & G Oil Tool & Serv. Co. v. G & G Fishing Tool Serv.*, 158 Tex. 594, 314 S.W.2d 782 (Tex. 1958) (dictum); *accord*, *Maxey v. Rodman*, 444 S.W.2d 353 (Tex. Civ. App.—El Paso 1969), *error ref. n.r.e.*; *Economy Filling Station v. Humble Oil & Ref. Co.*, 3 S.W.2d 832 (Tex. Civ. App.—Waco 1928), *error dismissed*. See generally 3 W. FLETCHER, *supra* note 37, at 800; *Hamilton & Shields*, *supra* note 4, at 94.

⁵² *Petroleum Anchor Equip., Inc. v. Tyra*, 410 S.W.2d 238, 245 (Tex. Civ. App.—Dallas 1966), *rev'd on other grounds*, 419 S.W.2d 829 (Tex. 1967) (dictum); *Sutton v. Reagan & Gee*, 405 S.W.2d 828, 836 (Tex. Civ. App.—San Antonio 1966), *error ref. n.r.e.*; *Almar-York Co. v. Fort Worth Nat'l Bank*, 374 S.W.2d 940, 942 (Tex. Civ. App.—Fort Worth 1964), *error ref. n.r.e.*; *Kilsby v. Aero-Test Equip. Co.*, 301 S.W.2d 703, 709 (Tex. Civ. App.—Dallas 1957), *error ref. n.r.e.*; *Palmetto Lumber Co. v. Gibbs*, 42 S.W.2d 120, 131 (Tex. Civ. App.—Beaumont 1932), *aff'd*, 124 Tex. 615, 80 S.W.2d 742, *rehearing denied*, 124 Tex. 625, 82 S.W.2d 376 (1935); *Knowles v. Northern Tex. Traction Co.*, 121 S.W. 232, 240 (Tex. Civ. App. 1909), *error dismissed*; see *Henger v. Sale*, 365 S.W.2d 335, 340 (Tex. 1963) (shareholder attack on informally authorized repayment of loans to insiders unsuccessful); *Camp v. Shannon*, 162 Tex. 515, 519, 348 S.W.2d 517, 519 (1961) (informal shareholder action unsuccessfully attacked in action by former officer); *Caldwell v. Kingsberry*, 451 S.W.2d 247, 251 (Tex. Civ. App.—Austin 1970), *error ref. n.r.e.* (shareholders bill attacking informal action by shareholders; plaintiff barred by his participation in questioned meeting). *But cf.* *Curtis v. Pipelife Corp.*, 370 S.W.2d 764, 767 (Tex. Civ. App.—Eastland 1963) (informal action by directors of Delaware corporation ineffective);

in *Rosenthal Produce Co. v. Tasinc Corp.*⁵³ a corporation was unable to set aside a summary judgment entered against it on two notes by having its president state in his controverting affidavit that the corporate minutes did not reflect that any authority had been given those who signed the notes. The court held that no fact issue of lack of authority had been raised, ruling that "a corporation cannot evade liability on its contracts merely by showing that its own minute book failed to record explicit authority by the board of directors to an officer to sign the same."⁵⁴

Similarly, in *New v. First National Bank*⁵⁵ a corporation was held bound on a note signed by its vice president pursuant to a general resolution adopted by the board authorizing borrowing from the bank, although the corporation contended the transaction resulted from internal mismanagement and wrongdoing by its officers. The court ruled that unless it was shown the bank had knowledge of the wrongdoing, the note remained valid.

Long-Term Employment Contracts. The validity and construction of long-term employment contracts have long been problems in Texas law. For many years, Texas courts took a dim view of such agreements, especially when they provided employment for corporate officers, and deemed them against public policy for impinging on the prerogatives of future boards of directors.⁵⁶ Even after liberalizing legislation was passed,⁵⁷ the Texas Supreme Court constricted its application in *Pioneer Specialties, Inc. v. Nelson*⁵⁸ by holding a standard bylaw provision calling for annual election of officers limited the power of the corporation to employ an officer for a term longer than a year. However, a step in the right direction was taken in *Dixie Glass Co. v. Pollak*,⁵⁹ which properly held that if the directors had the power to amend the bylaws their subsequent action in employing an officer for a long term would be deemed an informal amendment of the bylaws permitting such employment. But so long

see TEX. BUS. CORP. ACT ANN. art. 9.10 (1956) (action may be taken by shareholders or directors without meeting if action unanimously agreed upon). See generally 2 W. FLETCHER, *supra* note 37, §§ 394, 394.1; H. HENN, *supra* note 12, at 417; Hamilton, *supra* note 5, at 990; Annot., 64 A.L.R. 712, 726 (1929).

⁵³ 470 S.W.2d 448 (Tex. Civ. App.—Dallas 1971).

⁵⁴ *Id.* at 450.

⁵⁵ 476 S.W.2d 121 (Tex. Civ. App.—El Paso 1971), *error ref. n.r.e.*

⁵⁶ *Edwards v. Keller*, 133 S.W.2d 823, 825 (Tex. Civ. App.—Dallas 1939), *error dismissed, judgment correct, noted in* 18 TEXAS L. REV. 336 (1940); *Beaton v. Continental Southland Sav. & Loan Ass'n*, 101 S.W.2d 905, 909 (Tex. Civ. App.—Dallas 1937), *error dismissed, noted in* 16 TEXAS L. REV. 260 (1938); *Denton Milling Co. v. Blewett*, 254 S.W. 236, 238 (Tex. Civ. App.—Texarkana 1923), *error ref.; see* 3 I. HILDEBRAND, *supra* note 41, at 104; Heath, *Long-Term-Employment Contracts*, 8 BULL. OF THE SECTION ON CORPORATION, BANKING & BUSINESS LAW, Apr. 1970, at 8.

⁵⁷ In 1951, then art. 1327 was amended to allow the directors to enter into long-term employment contracts with any of the corporation's officers, agents or employees, when not prohibited by the charter or bylaws at the time the contract was executed. Ch. 20, § 1, [1951] Tex. Laws 27, *repealed*, ch. 229, § 1, [1961] Tex. Laws 460. In 1955, the TBCA was adopted. Among its articles were provisions generally empowering the corporation to elect or appoint officers and agents for such period of time as it might determine, authorizing the election of officers at the time and in the manner prescribed in the bylaws, and permitting removal of an officer at will by the board, but without prejudice to the officer's contract rights, if any. TEX. BUS. CORP. ACT ANN. arts. 2.02(A)(12), 2.42(A), 2.43 (1956).

⁵⁸ 161 Tex. 244, 399 S.W.2d 199 (1960), *noted in* 15 Sw. L.J. 440 (1961); 40 TEXAS L. REV. 402 (1962).

⁵⁹ 341 S.W.2d 530, 535 (Tex. Civ. App.—Houston 1960), *error ref. n.r.e.*, 162 Tex. 440, 347 S.W.2d 596 (1961).

as the power to amend the bylaws remains with the shareholders, the only safe way to assure the validity of such contracts in Texas is a specific bylaw provision authorizing them.⁶⁰

Some of these competing policies and views are reflected in a recent opinion by the Beaumont court of civil appeals. *Miller v. Angelina & N.R. Railroad*⁶¹ dealt with the validity of a contract employing the plaintiff as general manager and vice president of the defendant railroad for a twelve-year period. The contract had been executed in behalf of the defendant by its president, but had not been expressly approved by the board; however, a bylaw specifically conferred power on the president to appoint the railroad's general manager. The court rejected the railroad's argument that long-term employment contracts were against public policy, since the purpose of the amendment to article 1327 in 1951⁶² and the effect of later adoption of the TBCA was to change that policy. A Texas corporation may enter into an employment contract beyond a year, even though the term of office for directors and officers is limited to that period, particularly when the position involved is that of a general manager and not an officer.⁶³ To the contention that under the bylaw in question there is a difference between appointing a general manager and contracting with one, the court correctly construed the bylaw as a delegation of authority to the president, not only to appoint a general manager, but necessarily to contract to employ him—otherwise the power of appointment granted would become meaningless. The case accords with the spirit of the TBCA and clearly the court's interpretation of the bylaws was an eminently sensible one.

There were two other decisions involving long-term employment contracts. In one⁶⁴ an insurance salesman successfully maintained venue in an action for breach of a lifetime employment contract with the defendant insurance company. The contract was between the plaintiff and the managing director of a predecessor business taken over by the defendant pursuant to a directors' resolution authorizing the managing director to make all agency contracts. While nothing in the corporate minutes reflected express approval of the plaintiff's contract, evidence showing the plaintiff worked under the terms of the agreement for ten years, including three years after the defendant purchased the predecessor company, amply proved ratification. Although Texas courts seldom favor lifetime contracts,⁶⁵ the opinion made only an oblique reference to this point.

⁶⁰ Another possibility is to employ the individual as a general manager or officer, with compensation to be paid for that position, and having him agree he will serve in any office to which he might be elected without additional compensation. See 1 G. WASHINGTON & J. BISHOP, COMPENSATING THE CORPORATE EXECUTIVE 40 (3d ed. 1962).

⁶¹ 476 S.W.2d 389 (Tex. Civ. App.—Beaumont 1972), error ref. n.r.e.

⁶² Ch. 20, § 1, [1951] Tex. Laws 27, repealed, ch. 229, § 1, [1961] Tex. Laws 460.

⁶³ *Little v. Employers Sec. Life Ins. Co.*, 343 S.W.2d 517, 521 (Tex. Civ. App.—Dallas 1961), error ref. n.r.e.; *Dixie Glass Co. v. Pollak*, 341 S.W.2d 530, 535 (Tex. Civ. App.—Houston 1960), error ref. n.r.e., 162 Tex. 440, 347 S.W.2d 596 (1961).

⁶⁴ *Confederated Life Ins. Co. v. Mickler*, 482 S.W.2d 289 (Tex. Civ. App.—San Antonio 1972), error dismissed.

⁶⁵ See, e.g., *Nelms v. A & A Liquor Stores, Inc.*, 445 S.W.2d 256, 259 (Tex. Civ. App.—Eastland 1969), error ref. n.r.e.; *Brown v. Grayson Enterprises, Inc.*, 401 S.W.2d 653, 657 (Tex. Civ. App.—Dallas 1966), error ref. n.r.e. See generally 2 W. FLETCHER, *supra* note 37, § 597.1; Annot., 28 A.L.R.2d 929 (1953) (power of corporate officer or agent to hire employee for life).

The other case⁶⁶ dealt with construction of another insurance company employment contract, this one of an individual as executive vice president and managing director for a three-year period. The contract included a provision allowing the officer to serve on a consulting basis at the minimum salary specified for the balance of the contract term if he were removed from office without having committed specified acts of misconduct. The officer was removed within a year, but the company continued paying him until he died a few months later. His executrix sued, seeking the salary he would have received under the contract had he lived for the remaining two years, contending that the contract specifically provided for it to continue for a full thirty-six months unless the officer died while active as vice president or his employment terminated for contingencies that had not occurred. The court declined to construe the contract in this manner, and reasoned that any payments made after his removal would have to be for services performed, which his estate could certainly not make in his behalf after his death. Therefore, the case fell within the general rule that continued life of the employee is a constructive condition imposed by law in any personal service contract, absent clearcut language in the contract showing contrary intent.⁶⁷

III. CLOSE CORPORATIONS

There were only a few close corporation cases decided during the year, but one was especially noteworthy. In *Ling & Co. v. Trinity Savings & Loan Ass'n*⁶⁸ the Texas Supreme Court gave new life to several key sections of the TBCA governing stock transfer restrictions by correcting a serious misconstruction of those provisions by the lower courts that had cast doubt on the efficacy of all first option arrangements.

Ling and Company was a Dallas stock brokerage firm whose class A common shares were subject to restrictions on transferability imposed in its articles of incorporation. In brief, the restrictions required written approval by the New York Stock Exchange prior to the sale or encumbrance of the shares if Ling was then a member of the Exchange.⁶⁹ They further required that before a shareholder could sell or transfer his shares, he must first notify the corporation, which then had a thirty-day option to purchase all or part of the shares at a price based on a formula that partially reflected book value. If Ling did not exercise its option, notice then was to be given all holders of the same class who had a ten-day option to buy any stock not purchased by Ling on a pro rata basis. Any shares not bought could then be disposed of

⁶⁶ *Nutt v. Members Mut. Ins. Co.*, 474 S.W.2d 575 (Tex. Civ. App.—Dallas 1971), error ref. n.r.e.

⁶⁷ The court cited 3A A. CORBIN, CONTRACTS § 632 (1960); RESTATEMENT OF CONTRACTS § 253 (1932).

⁶⁸ 482 S.W.2d 841 (Tex. 1972).

⁶⁹ Ling had to impose the requirement to maintain its membership in the New York Stock Exchange under the latter's existing rule 313.24 (reproduced in 1970 BNA SEC. REG. & L. REP. NO. 42, at X-22, Mar. 18, 1970). The rule was repealed in 1970. The NYSE now requires that brokerage firms must redeem or convert common stock held by a principal stockholder if the Exchange withdraws its approval of his ownership. NYSE CONST. art. IX, § 7(g). The impact of the change on Texas stock brokerage firms is discussed in 50 TEXAS L. REV. 528 n.3 (1972).

without restriction. The class A stock certificates contained a legend in small type on the front of the certificate that shares were subject to all the terms, conditions, and provisions of the articles of incorporation which were incorporated by reference therein and referred to the reverse side for specific references to provisions setting out preferences, limitations, and restrictions. The back of the certificate contained a long sentence in small type, preceded by the word "NOTICE" in larger bold-face type, which stated that transfers of shares were subject to certain restrictions and required the holder under certain conditions to grant successive options to the corporation and other shareholders.

Bowman, a Ling stockholder, owned 1,500 shares of class A stock, evidenced by a certificate containing the restrictive legend. He pledged the stock certificate to Trinity Savings and Loan as collateral for a loan from Trinity without observing any of the restrictions. When he defaulted in payment, Trinity sued for the unpaid balance on the note and to foreclose on the stock certificate. Ling was a made party to the suit because of its insistence that Bowman had violated the transfer restrictions by his pledge. Bowman did not contest the suit, and both Ling and Trinity moved for summary judgment, Trinity contending the restrictions were invalid and Ling asserting they had been violated. The trial court granted summary judgment to Trinity and was affirmed by the Waco court of civil appeals.⁷⁰

The Waco court found the restrictions invalid for several reasons. (1) They were vaguely stated and not conspicuously noted on the stock certificate as required by the Uniform Commercial Code.⁷¹ (2) They were unreasonable in requiring consent by the New York Stock Exchange, a third party, without any criteria indicated for the giving or withholding of consent by the Exchange. (3) The procedure for the exercise of the successive options to the corporation and the other shareholders placed an unreasonable burden on the shareholder. (4) Because there were more than twenty class A shareholders, the restrictions fell outside the scope of article 2.22(B)(2),⁷² which permits restrictions reasonably defining rights and obligations of shareholders of a class in connection with a buy-sell agreement, so long as there are no more than twenty holders of record of such class.

As might be expected, the decision caused considerable consternation among the corporate bar and was deservedly criticized.⁷³ The court's criticism of the general language used in the legend referring to the provisions of the articles of incorporation completely overlooked article 2.19(F),⁷⁴ which expressly

⁷⁰ *Ling & Co. v. Trinity Sav. & Loan Ass'n*, 470 S.W.2d 441 (Tex. Civ. App.—Waco 1971), *rev'd*, 482 S.W.2d 841 (Tex. 1972), *noted in* 50 TEXAS L. REV. 528 (1972).

⁷¹ Section 8-204 of the Uniform Commercial Code provides that "unless noted conspicuously on the security a restriction on transfer imposed by the issuer even though otherwise lawful is ineffective *except against a person with actual knowledge of it.*" TEX. BUS. & COMM. CODE ANN. § 8.204 (1968) (emphasis added).

⁷² TEX. BUS. CORP. ACT ANN. art. 2.22(B)(2) (1956).

⁷³ See Rogers, *Stock Transfer Restrictions*, 10 BULL. OF THE SECTION ON CORPORATION, BANKING & BUSINESS LAW, June 1972, at 1; 50 TEXAS L. REV. 528 (1972) (a very well written and researched analysis).

⁷⁴ TEX. BUS. CORP. ACT ANN. art. 2.19(F) (Supp. 1972). The 2.19(F) procedure has been utilized frequently by Texas lawyers, judging from the hundreds of filings of documents being incorporated by reference that have been made in the office of the secretary of

allows incorporation by reference to avoid the almost impossible task of having to set out in full or summary form all the details and complexities of stock transfer restrictions within the confines of a typical stock certificate. And while the court was probably correct in its view that the restriction was not conspicuously noted, it failed to consider whether Trinity might not have actually known of its existence, and thus come under the exception to the UCC rule it was applying.⁷⁵ Likewise, the court may have been on sound ground in disapproving the consent restraint involving the New York Stock Exchange,⁷⁶ but again neglected to consider whether such restraints might not be proper for a corporation engaged in a highly regulated industry that handles money and securities belonging to clients.⁷⁷ Moreover, in stating that the prevailing case law recognizes free alienability as an inherent attribute of securities and invalidates unreasonable consent restraints on alienation, the court cited no case later than 1929.⁷⁸ Obviously, the court did not take account of the countervailing policy which considers the corporate charter a contract whose terms the corporation and its shareholders should be given freedom to mold,⁷⁹ nor of the more recent case law and legislation which has recognized

state. Pelletier & Marsh, *Incorporation Planning in Texas*, 23 Sw. L.J. 820, 840 (1969); see Carrington, *The Texas Business Corporation Act As Enacted and Ten Years Later*, 43 TEXAS L. REV. 609, 616 n.26 (1965); Slover, *1957 Amendments to Texas Business Corporation Act*, 20 TEX. B.J. 515, 516 (1957).

⁷⁵ TEX. BUS. & COMM. CODE ANN. § 8.204 (1968); see note 71 *supra*.

⁷⁶ Although commonly recognized in English law, older cases almost uniformly declared consent restraints unreasonable and, therefore, invalid. F. O'NEAL, *CLOSE CORPORATIONS LAW & PRACTICE* § 7.08 (2d ed. 1971). On the other hand, more recent decisions have tended to uphold these restrictions, provided consent is not withheld arbitrarily or for personal instead of good business reasons. *Id.* See also 1 F. CHRISTY, *THE TRANSFER OF STOCK* § 38 (5th ed. 1972); H. HENN, *supra* note 12, at 554; 1 G. HORNSTEIN, *supra* note 45, at 252; W. PAINTER, *CORPORATE AND TAX ASPECTS OF CLOSELY HELD CORPORATIONS* 86 (1971); G. ROHRLICH, *ORGANIZING CORPORATE AND OTHER BUSINESS ENTERPRISES* 129 (4th ed. 1967); see note 91 *infra*.

⁷⁷ For example, in another context, corporations which privately distribute securities which have not been registered under the Securities Act of 1933 in reliance on the non-public offering exemption in § 4(2), 15 U.S.C. § 77d(2) (1970), will frequently, to protect themselves against loss of the exemption, place a legend on the certificates representing the shares which states that the shares cannot be transferred unless they are registered or an exemption from registration is available. Transfer may also be conditioned on obtaining the prior written consent of counsel for the issuer. Restrictions of this sort and the right of the corporation to impose them have generally been upheld. See *General Dev. Corp. v. Carlin*, 139 So. 2d 901 (Fla. App. 1962); *Lieberman v. Lincoln Rochester Trust Co.*, 56 Misc. 2d 81, 228 N.Y.2d 186 (Sup. Ct.), *aff'd*, 30 App. Div. 2d 1049, 295 N.Y.S.2d 623 (1968). See generally S. GOLDBERG, *PRIVATE PLACEMENTS AND RESTRICTED SECURITIES* § 2.6 (1971); 1 C. ISRAELS & E. GUTTMAN, *MODERN SECURITIES TRANSFERS* § 4.06 (rev. ed. 1971).

⁷⁸ The court cites *Howe v. Roberts*, 209 Ala. 80, 85 So. 344 (1923); *People ex rel. Malcolm v. Lake Sand Corp.*, 251 Ill. App. 499 (1929); *New England Trust Co. v. Abbott*, 162 Mass. 148, 38 N.E. 432 (1894); *Morris v. Hussong Dyeing Mach. Co.*, 81 N.J. Eq. 256, 86 A. 1026 (Ch. 1913). However, the Massachusetts court in *New England Trust* upheld a first-option transfer restriction on a contract theory, and Justice Holmes, writing for the court a few years later, anticipated the liberal trend towards permitting such restrictions: "There seems to be no greater objection to retaining the right of choosing one's associates in a corporation than in a firm." *Barrett v. King*, 181 Mass. 476, 479, 63 N.E. 934, 935 (1902). Compare the Illinois decision cited by the court with *Galler v. Galler*, 32 Ill. 2d 16, 203 N.E.2d 577, 585 (1965) (upholding a far-reaching shareholders' agreement and stating: "[T]he courts can no longer fail to expressly distinguish between the close and public-issue corporation when confronted with problems relating to either.").

⁷⁹ See *Allen v. Biltmore Tissue Corp.*, 2 N.Y.2d 534, 141 N.E.2d 812, 161 N.Y.S.2d 418 (1957), in which the conflict between the contract and property theories is discussed. See also W. PAINTER, *supra* note 76, at 84; Gower, *Some Contrasts Between British and American Corporation Law*, 69 HARV. L. REV. 1369, 1376 (1956); O'Neal, *Restrictions on*

the validity of consent restraints which are not applied arbitrarily.⁸⁰

Perhaps the aspect of the court's opinion that caused the most concern was its condemnation of the successive first option procedure and the mode by which the price was to be determined as unreasonable. The mechanics and pricing formula set out in Ling's articles seem almost boiler-plate in origin and undoubtedly approximate hundreds of other first option arrangements that have been employed in setting up close corporations in Texas. To say, as the court does, that such procedure "puts such a burden on the shareholder as to be unreasonable,"⁸¹ even apart from the New York Stock Exchange approval requirement, ignores the need for careful drafting that anticipates the problems first option arrangements were devised to overcome. Actually, the provisions in *Ling* were less complicated and endured for a shorter span of time than those approved years earlier in *Coleman v. Kettering*,⁸² also not considered by the court.

Finally, and perhaps most egregiously of all, the court construed article 2.22 to arbitrarily limit the imposition of valid stock transfer restrictions to corporations having no more than twenty shareholders; thus, magically transforming first option arrangements into buy-sell agreements through its judicial sleight of hand. A reading of article 2.22(B) will show that subsection (2) is but one of three coequal examples of restrictions on transferability that can be imposed "in addition to any other restrictions which may reasonably be imposed on the transfer of shares by any corporation."⁸³ One of the other two sections recognizes restrictions reasonably defining preemptive or prior rights of the corporation or its shareholders of record to purchase any of its shares offered for transfer,⁸⁴ and the other recognizes "restrictions reasonably defining rights of the corporation or of any other person or persons, granted as an option or options or refusal or refusals on any shares."⁸⁵ Since the latter category specifically includes option provisions of the sort imposed by Ling, it is manifest the legislature recognized that a first option arrangement and a

Transfer of Stock in Closely Held Corporations: Planning and Drafting, 65 HARV. L. REV. 733, 778 (1952).

⁸⁰ See note 78 *supra*.

⁸¹ 470 S.W.2d at 445.

⁸² 289 S.W.2d 953 (Tex. Civ. App.—Galveston 1956). *Coleman* was the first to uphold the validity of first option arrangements in Texas, although an earlier supreme court decision involving a membership certificate in an unincorporated pilot's association had stated by way of dictum that reasonable restraints on the assignability or encumbrance of shares in private corporations or associations are valid. *Citizens State Bank v. O'Leary*, 140 Tex. 345, 352, 167 S.W.2d 719, 722 (1943). The restrictions approved in *Coleman* are set out at 289 S.W.2d at 957-59 and provided for successive 20-day options involving as many as five offers.

⁸³ TEX. BUS. CORP. ACT ANN. art. 2.22(B) (1956). The bar committee's comment states that the restrictions set out in § B are not intended to be exclusive and that other types of reasonable restrictions may be equally valid. Committee Comments, 3A TEX. REV. CIV. STAT. ANN. 105 (1956). The court's confusion of a first option with a buy-sell agreement in view of the obvious use of the latter term in its technical sense in art. 2.22(B)(3) is almost inexplicable, unless it believed all transfer restrictions fall generically within the buy-sell category. 50 TEXAS L. REV. 528, 533 (1972). The most charitable explanation is that the court must have felt Ling, perhaps because of its New York Stock Exchange membership, was a publicly-held corporation, since it was stipulated it had more than 20 shareholders, and that any restriction on the transfer of its shares would be unreasonable and unfair to the public shareholders.

⁸⁴ TEX. BUS. CORP. ACT ANN. art. 2.22(B)(1) (1956).

⁸⁵ *Id.* art. 2.22(B)(3).

buy-sell agreement represent different types of restrictions. In its wisdom, the legislature chose to impose the twenty-shareholder limit on only the buy-sell agreement;⁸⁶ it is difficult to see why the court felt the need to thus amend the statute, especially when it possibly had more tenable grounds for its decision.

Fortunately, the supreme court agreed to review the Waco court's decision, and in a brief but well-considered opinion by Justice Reavley reversed and remanded, repudiating almost every ground the court of civil appeals used to justify its decision. First, the court held the language used on the stock certificate properly incorporated the stock transfer restrictions in Ling's articles by reference, as permitted by article 2.19(F).

Second, it agreed the restriction or reference thereto had not been conspicuously noted. In its view, the UCC requirement meant that "something must appear on the face of the certificate to attract the attention of a reasonable person when he looks at it."⁸⁷ But this did not mean that Trinity was entitled to summary judgment, since the record did not establish conclusively that it lacked knowledge of the restriction when Bowman assigned it the stock.

Third, in view of Ling's membership in the New York Stock Exchange when the consent restraint was first imposed, and the Exchange rule requiring its approval of any sale or pledge of the stock, the provision requiring such approval was not arbitrary, capricious, and unreasonable. More would have to be shown than the mere presence of the restraint in the articles.

Fourth, the provision requiring the shareholders be notified and given an opportunity to buy the stock if the corporation did not, was not oppressive or unusual. The court conceded the number of shareholders might be so great that the requirement would become too burdensome on the shareholder, but nothing in the record showed this was the case.

Finally, the court held the twenty-shareholder limit on buy-sell agreements in article 2.22(B)(2) had no application to the restrictions, noting that such agreements usually refer to contracts among shareholders rather than restrictions imposed by the corporation. "In any event, there is no obligation to purchase this stock imposed upon anyone, and these restrictions can only be con-

⁸⁶ Paul Carrington, who was chairman of the state bar committee which drafted the TBCA and was principal draftsman of art. 2.22, explained the 20-shareholder limit on buy-sell agreements as based on the fear that if such agreements were to be enforced by corporate restrictions on transferability, they would become unwieldy and unworkable. He suggested, therefore, that if more than 20 shareholders were involved, they work out their own restrictions by escrow, voting trust, or separate agreement to which the corporation was not a party. Panel Discussion, *The Problems of Closely Held Corporations*, in TEXAS BUSINESS CORPORATION ACT PROCEEDINGS 105, 140 (1955), reprinted in 3A TEX. REV. CIV. STAT. ANN. 535, 567 (1956).

⁸⁷ 482 S.W.2d at 843. The UCC defines "conspicuous" as used in the Code, in part, as follows: "A term or clause is conspicuous when it is so written that a reasonable person against whom it is to operate ought to have noticed it. A printed heading in capitals . . . is conspicuous. Language in the body of a form is 'conspicuous' if it is in larger or other contrasting type or color Whether a term or clause is 'conspicuous' or not is for decision by the court." TEX. BUS. & COMM. CODE ANN. § 1.201(10) (1968). In the *Ling* case the provision on the back of the certificate stating that transfer of the shares were subject to options was headed by the word "Notice" in capital letters larger than the rest of the legend and was the only language on the back other than the usual assignment form; arguably this should have been enough to alert a reasonable person seeing it, although admittedly nothing on the face of the certificate would have done so. See Rogers, *supra* note 73, at 3.

sidered as options and not 'buy and sell agreements.'"⁸⁸ The summary judgment proof, therefore, did not justify the holding that Trinity was not bound by the stock transfer restrictions.

Thus, thanks to the supreme court, article 2.22 once again means what it says. Moreover, for the first time in Texas case law, there is recognition that under some circumstances even consent restraints can be imposed. But on the other side of the coin, the court also emphasized that section 8.204 of the Business and Commerce Code also means what it says, and that to be enforceable against a transferee without knowledge, a stock transfer restriction must be printed or noted in type large enough or in some other manner that a reasonable man's attention will be called to it. The chances are that a number of transfer restrictions found on stock certificates of Texas close corporations are legended in type no larger than that employed by Ling. One reason may be the tendency of lawyers to look to the TBCA alone for guidance in such matters, forgetting the UCC article on investment securities despite the reminder of its existence in article 2.22(E).⁸⁹ It would be helpful if the TBCA reiterated the conspicuous notation requirement, and one of the proposed amendments to the TBCA that has been introduced in the current legislative session does precisely that.⁹⁰ Another proposed amendment also deals more explicitly with stock transfer restrictions by specifying a greater number of permissible restrictions,⁹¹ along the lines of recent legislation in other states.⁹² While article 2.22 was one of the very first state statutes that sanctioned reasonable transfer restrictions, its language does contain some ambiguities.⁹³

⁸⁸ 482 S.W.2d at 845.

⁸⁹ "Except as otherwise expressly provided in this Article, no provision of Article 8—Investment Securities of the Uniform Commercial Code of this State shall be deemed to be amended or repealed by any provision of this Act." TEX. BUS. CORP. ACT ANN. art. 2.22(E) (1956).

⁹⁰ Among the amendments proposed is a substantial revision of art. 2.19 which would include the following definition as § H:

As used in this Article and Article 2.22 the term 'conspicuous' or 'conspicuously' when prescribed for information appearing on a certificate for shares or other securities means the use of type of sufficient size, color, or character that a reasonable person against whom such information may operate should notice it. For example, a printed or typed statement in capitals or bold-face or underlined type, or in type that is larger than or that contrasts in color with that used for other statements on the same certificate is 'conspicuous.'

S.B. 202, H.B. 329, 63d Legis. § 11 (1973).

⁹¹ The proposed amendment is a complete redraft of art. 2.22. It (1) specifies that corporate shares are personal property for all purposes; (2) permits the imposition of restrictions on transfers in the articles, bylaws, shareholder agreements, and agreements between shareholders and the corporation, if in the latter case a counterpart is deposited in the corporation's principal office and available for shareholder inspection; (3) makes restrictions binding on transferees unless not conspicuously noted on the certificate; and (4) specifically recognizes certain types of reasonable restrictions as among those that may be created: *i.e.*, (a) first option arrangements, (b) buy-sell provisions, (c) consent restraints to prevent violations of federal and state law, (d) prohibitions against transfer to designated persons or classes of persons if the designation is not manifestly unreasonable, and (e) maintenance of the corporation's status for subchapter S or close corporation purposes. S.B. 202, H.B. 329, 63d Legis. § 12 (1973).

⁹² See, *e.g.*, CONN. GEN. STAT. REV. tit. 33, § 306a (Supp. 1973); DEL. CODE ANN. tit. 8, § 202 (1968); NEV. REV. STAT. § 78.242 (1969); N.J. REV. STAT. § 14A:7-12 (1969); PA. STAT. ANN. tit. 15, § 1613.1 (Supp. 1972); WYO. STAT. ANN. § 17-36.22 (1965); *cf.* ME. REV. STAT. ANN. tit. 13A, §§ 616-18 (Supp. 1972).

⁹³ "The wording of Art. 2.22 has caused some confusion and concern as to whether and how stock transfer restrictions imposed privately by agreements among shareholders may be preserved and enforced without imposition of restrictions by the corporation." Rogers, *supra*

The *Ling* case is not the first which may have resulted from that fault,⁹⁴ and the new proposals, if enacted, should be a marked improvement.

Dissension and Deadlock. Among the eventualities participants in small or closely-held enterprises should expect to face is the possibility that the disagreements about business policies or decisions that almost inevitably occur in any close relationship will one day degenerate into such hostility and distrust that further association becomes impossible. The danger is no less acute in close corporations than in partnerships, but, given a corporation's perpetual existence and the necessity of having a two-thirds vote or more to dissolve,⁹⁵ voluntary dissolution may be much more difficult to attain. As a result, dissident parties may find themselves frozen in, owning stock in a corporation for which there is no market, and desperately trying to find a way to break the deadlock. Of course, there are always the possibilities of receivership,⁹⁶ ultimate involuntary dissolution,⁹⁷ or, conceivably, an agreement to submit the dispute to binding arbitration.⁹⁸ Needless to say, a well-drafted close corporation agreement will seek to alleviate the deadlock problem by making provision for buy-out arrangements, arbitration, or dissolution at will. But in the absence of such arrangements, as is generally the case, the parties will have to work out their own solution. But even here, care must be taken to see that a participant does not end up in a poorer position than he was in before, as a recent case illustrates.

In *Northrup v. O'Brien*⁹⁹ two stockholders, who each owned half the shares in a Texas corporation, had begun to disagree, and decided to resolve their differences by bringing in an experienced outsider to provide additional expertise and management. On the mistaken assumption that the outsider, Northrup, would have to be a shareholder in order to be a director,¹⁰⁰ each share-

note 73, at 4. Nor is it clear whether the arrangements permitted in § B may be imposed in the articles or bylaws, or, conversely, whether those restrictions are valid if not set out in full or summary form on the stock certificates as prescribed in § A. See 38 TEXAS L. REV. 499, 500 (1960). The *Ling* case itself indicates confusion as to the manner in which the restriction is to be stated on the shares. Another ambiguity is the reference in § (B) (1) to "pre-emptive" rights of the corporation to purchase shares offered for transfer, since normally the pre-emptive right is an individual one granted shareholders, not the corporation.

⁹⁴ See, e.g., *Irwin v. Prestressed Structures, Inc.*, 420 S.W.2d 491 (Tex. Civ. App.—Amarillo 1967), error ref. n.r.e., discussed in Castle, *Restrictions on Transferability of Securities*, 7 BULL. OF THE SECTION ON CORPORATION, BANKING & BUSINESS LAW, Jan. 1969, at 9; *Sandor Petroleum Corp. v. Williams*, 321 S.W.2d 614 (Tex. Civ. App.—Eastland 1959), error ref. n.r.e., noted in 14 SW. L.J. 106 (1960); 38 TEXAS L. REV. 499 (1960).

⁹⁵ TEX. BUS. CORP. ACT ANN. art. 6.03(A)(3) (1956). The vote or concurrence of a greater majority can be required in the articles of incorporation for any corporate action. *Id.* art. 9.08.

⁹⁶ *Id.* art. 7.05(A)(1)(b) permits the appointment of a receiver to rehabilitate a corporation in an action brought by a shareholder in cases of deadlock among directors or in voting power among shareholders.

⁹⁷ If the rehabilitative receivership is not successful, the court can then order appointment of a receiver to liquidate the assets and business of the corporation and when that process is completed, decree its dissolution. *Id.* arts. 7.07, 7.08-10.

⁹⁸ See TEX. REV. CIV. STAT. ANN. art. 224 (Supp. 1972); Coulson, *Texas Arbitration—Modern Machinery Standing Idle*, 25 SW. L.J. 290 (1971).

⁹⁹ 474 S.W.2d 614 (Tex. Civ. App.—Dallas 1971).

¹⁰⁰ Directors need not be Texas residents or shareholders unless the articles of incorporation or bylaws so require. TEX. BUS. CORP. ACT ANN. art. 2.32 (1956).

holder agreed to transfer two shares to him. There was no written agreement, however, and Northrup's stock certificate for his four shares contained no restrictions. Subsequently, one of the shareholders, Mrs. O'Brien, became dissatisfied with Northrup's involvement, and demanded he give back her two shares, claiming that when she gave him the stock, she intended he would return the shares upon her request. He refused, and she sued Northrup and the other shareholder, charging them with conspiring to deprive her of representation, and seeking to be declared the owner of the two shares. On a motion for summary judgment, the trial court declared she had title and possession of the stock.

On appeal, the Dallas court of civil appeals reversed and remanded, primarily because there was a triable issue of fact concerning the stock ownership. Northrup had testified the shares had been given him in consideration of his services in aiding the corporation, and further that he was entitled to hold the stock to protect his wife's interest in a five-year lease on the premises occupied by the corporation. The other shareholder testified that at the time of the stock transfer there was no intention on the part of the parties that it was to be anything other than absolute or that the stock was returnable on request of either party. The court found that Mrs. O'Brien had not communicated her intent that the shares be returned, and that since the only testimony in support of her contention was her own, it was not so clear, direct, positive, or uncontradicted to say as a matter of law she owned the shares. The case clearly demonstrates that if a stranger is to be brought in to break a deadlock and given enough shares to put him in a swing position to vote with one side or the other to give one faction control, his role and the conditions under which he can hold or vote his stock must be spelled out.

Mrs. O'Brien's predicament is not necessarily unique. Another recent case shows that a divorce settlement can leave a wife at the mercy of her former husband and an associate in much the same fashion, even though she ends up with half of the community's stock. In *Braswell v. Braswell*¹⁰¹ a divorce court awarded Mrs. Braswell half of the stock she and her husband owned in a closely-held motor freight company that had grown from their \$1,200 investment in 1930 to a \$10 million business by 1970. She complained the court should have ordered the stock sold and the proceeds divided, because with the shares her former husband retained plus thirty-eight shares owned by an associate whom he dominated, she was locked in as a minority shareholder with no opportunity to receive dividends or liquidate her investment. The court noted, however, that her stock had been appraised as having a market value of \$3,775,896 even with control in the husband. The court assumed she could liquidate her interest when she chose to do so, although it seems questionable that a minority block of stock could really command that value. As to dividends, which had not been paid since 1951, primarily because the Braswells lived on his salary so that earnings could be reinvested in the business, the court would not presume that management would not declare them in the future. If they were improperly withheld, there was always the minority share-

¹⁰¹ 476 S.W.2d 444 (Tex. Civ. App.—Waco 1972), error dismissed.

holder's right to compel their declaration.¹⁰² Thus, Mrs. Braswell was left in the same situation as Mrs. O'Brien, with the same potential for future litigation.

Valuation of Close Corporation Stock. Because by definition there is no public market for shares in a closely-held corporation, determining their value can become a troubling task. The need for such valuation arises in a number of contexts: when the business is to be sold outright or acquired by merger or exchange of stock; when stock is given away to family members to minimize death taxes or to charitable institutions to lessen income taxes; when planning an estate, particularly where the bulk of the estate will consist of the close corporation stock; when drafting first option or buy-sell agreements in anticipation of the death, disability, or withdrawal of key stockholders; when establishing qualified stock option or employee stock purchase plans; and probably most importantly, when determining valuation for estate or inheritance tax purposes.¹⁰³ If litigation ensues and the value of the close corporation stock becomes an issue, proof of value frequently comes from an expert's testimony. Factors that should enter into his valuation were considered in one of the survey cases.

In *English v. Ramo, Inc.*¹⁰⁴ a key part of the opinion dealt with expert testimony on the value of the stock which a parent had acquired in purchasing a subsidiary from its former owners. When the former owners of the subsidiary, Red Ball Motor Freight, sold out to the parent, Ramo, Inc., they warranted that the routes used by Red Ball's trucks were covered by certificates of necessity and no others were needed to continue the trucking business it was engaged in at the time of the sale. After Ramo assumed control, it discovered that on two of the routes Red Ball's drivers had been taking shorter but unauthorized routes and that to discontinue them and haul the same freight over the longer authorized routes would increase operating expenses by well over \$300,000 per year. When the former owners sued for acceleration of the purchase money notes for violation of the security agreement limiting dividend distributions, Ramo asked for and received a setoff for breach of warranty in an amount equal to the increased expenses that would have been incurred using only the authorized routes. On this issue, its expert witness, Vaughan, who qualified as an appraiser of stock in closely held corporations, testified that because of the increased expenses the actual value of the stock was \$3,100,000 less than the \$15,500,000 it would have been worth if the facts

¹⁰² *Storrow v. Texas Consol. Compress & Mfg. Ass'n*, 87 F. 612, 616 (5th Cir. 1898); *Patton v. Nicholas*, 154 Tex. 385, 394, 279 S.W.2d 848, 854 (1955); *Moroney v. Moroney*, 286 S.W. 167 (Tex. Comm'n App. 1926), *judgment approved* (dictum); *Morrison v. St. Anthony Hotel*, 295 S.W.2d 246, 250 (Tex. Civ. App.—San Antonio 1956), *error ref. n.r.e.*; see Murray, *Legal and Financial Aspects of Dividend Policy*, 23 BAYLOR L. REV. 7 (1971).

¹⁰³ See generally 7 Z. CAVITCH, BUSINESS ORGANIZATIONS WITH TAX PLANNING § 148.04 (1972); I G. HORNSTEIN, *supra* note 45, § 196; 2 F. O'NEAL, *supra* note 76, § 7.24; W. PAINTER, *supra* note 76, at 93-96; G. ROHRICH, *supra* note 76, § 4.23; Butula, *Valuation of Securities of Closely Held Corporations*, 14 W. RES. L. REV. 193 (1963); Cohan, *Valuation of Interests in Closely Held Businesses*, 46 TRUST BULL., Sept. 1966, at 13; Page, *Setting the Price in a Close Corporation Buy-Sell Agreement*, 57 MICH. L. REV. 655 (1959).

¹⁰⁴ 474 S.W.2d 600 (Tex. Civ. App.—Dallas 1971), *error granted*; see notes 19, 20 *supra*, 141-45 *infra*, and accompanying text.

represented in the warranty had been true, *i.e.*, that Red Ball had authority to use the two routes. The plaintiffs contended Vaughan's testimony should not have been admitted because he had made no determination of actual value but simply assumed the purchase price of \$15,500,000 to be the fair market price in computing the difference between that figure and the probable increase in operating costs of the two routes.

The court, however, interpreted Vaughan's testimony as not being based on an assumption, but on his recognition that the sale itself was evidence of the market value, especially since there had been a bona fide transaction. The court rejected the argument that the only method of proving value in a closely-held corporation in the circumstances before it was by detailed appraisal of its assets, a method that would be difficult, expensive, and so time-consuming as to be impractical. The selling price having been determined by experienced and well-informed businessmen after careful investigation and negotiation, there was no reason why the figure they agreed upon could not be properly used as the basis for the expert testimony.¹⁰⁵ While it is sometimes said that evidence of the price at which closely-held stock is sold is entitled to little weight, the rule should be different when a sale involves a substantial block of the corporation's shares, or as here, all the shares, since the figures arrived at would normally come only after independent valuation by the parties concerned. Even granting there may have been other methods of valuation the expert could have utilized, the court's determination that the method used was proper seems sound.

IV. CORPORATION FINANCE

Issuance of Shares. Two cases were decided that involved the validity of consideration given for the issuance of shares, but both were disposed of on other grounds.

In *Prickett v. Allen*¹⁰⁶ a trustee in bankruptcy for a bankrupt corporation sued two of its shareholders to recover the stated value of shares which had been originally issued to them. The trustee alleged the shares were for a computer data package which defendants failed to deliver, forcing the corporation to develop its own. Alternatively, he claimed that if the agreed consideration had been delivered, the nature of any computer package was so unsubstantial and shadowy in nature that it would not satisfy the constitutional requirement that stock not be issued except for money paid, labor done, or property actually received.¹⁰⁷ The trustee moved for summary judgment which the trial court granted, despite an affidavit by one of the defendants that the computer pack-

¹⁰⁵ The trial court admitted evidence that Red Ball had later been authorized to use one of the shorter routes, but instructed the jury the evidence could not be considered in determining the value of Red Ball's stock at the time of the transaction. The plaintiffs argued on appeal that the evidence should have been admitted for all purposes because it established that no damages in fact resulted from lack of authority to use the route in question. The court ruled, however, that developments occurring after the sale would not be relevant on the issue of market value on the date of the sale unless pertinent to the prospects the parties had in mind at the time of the sale. 474 S.W.2d at 609.

¹⁰⁶ 475 S.W.2d 308 (Tex. Civ. App.—Eastland 1971).

¹⁰⁷ TEX. CONST. art. XII, § 6; *see* TEX. BUS. CORP. ACT ANN. art. 2.16(A) (Supp. 1972).

age had been delivered and in which he detailed the work he had performed in assessing the market for data processing in the Amarillo area. The appellate court quite properly held the affidavit showed the existence of material issues of fact which precluded summary judgment. The court ruled that even if the package had not been delivered, the affidavit raised a triable issue of fact, since it indicated the defendant had expended sufficient labor to satisfy the constitutional requirement. Regretfully, the court did not pass on whether the computer package was sufficiently tangible to constitute property for stock issuance purposes—a matter still clouded by earlier case law.¹⁰⁸

The other case marked the second time around for a dispute concerning the issuance of stock for services.¹⁰⁹ The plaintiff claimed that when his brother, an officer-director and one of three shareholders of a close corporation, employed him as plant superintendent in July 1959, he was orally promised that, if he would take a reduced salary of \$600 per month, he would receive twelve and one-half percent of the corporation's stock. When plaintiff demanded the stock in December 1966, the other stockholder-directors refused, denying there was such an agreement. The plaintiff first sued for the stock in April 1967, and suffered a summary judgment which was reversed and remanded by the Amarillo court of civil appeals¹¹⁰ because an issue of fact existed on estoppel to plead limitations. The Amarillo court indicated, however, that the lack of formal action by the board in setting the consideration for the issuance of stock¹¹¹ would not be determinative of plaintiff's rights. Moreover, article 2.16(B)¹¹² would not prohibit the plaintiff's being issued stock for services on the basis of the oral promise, but merely forbade any issuance prior to the services or labor having been performed.

On remand, the plaintiff lost again in the trial court, and on appeal the Eastland court of civil appeals ruled his claim was barred by limitations. The jury

¹⁰⁸ Compare *O'Bear-Nester Glass Co. v. Antiexplor. Co.*, 101 Tex. 431, 108 S.W. 967 (1908) (unpatented formula too intangible to constitute "property"; "property" must be capable of being received and applied to corporate debts), with *Atlas Trailers & Water Mufflers, Inc. v. McCallum*, 118 Tex. 173, 178, 12 S.W.2d 957, 958 (1929) (patent is "property" though incorporeal and incapable of actual receipt in manner of corporeal property or of seizure on execution, since in the latter case it may be subjected to a creditor's bill); cf. *Beach v. McKay*, 108 Tex. 224, 191 S.W. 557 (1917); *Cherry v. First Tex. Chem. Mfg. Co.*, 144 S.W. 306 (Tex. Civ. App.—Dallas 1912), *error ref.*; see 2 I. HILDEBRAND, *supra* note 41, at 8. See generally H. BALLANTINE, *supra* note 49, § 345; H. HENN, *supra* note 12, at 306; N. LATTIN, *supra* note 6, at 466; Comment, *Some Problems Raised by Issuing Stock for Overvalued Property and Services in Texas*, 40 TEXAS L. REV. 376, 386 (1962); Annot., 37 A.L.R.2d 913 (1954) (patent right, copyright, trademarks, secret processes, formulas, or the like, as "property" within provisions of law or charter forbidding issuance of corporate stock except for money paid or property received).

¹⁰⁹ *Irwin v. Prestressed Structures, Inc.*, 471 S.W.2d 865 (Tex. Civ. App.—Eastland 1971), *error ref. n.r.e.* Plaintiff's brother had also had his turn in court against the same corporation and individual defendants in an action involving the validity of stock transfer restrictions. *Irwin v. Prestressed Structures, Inc.*, 420 S.W.2d 491 (Tex. Civ. App.—Amarillo 1967), *error ref. n.r.e.*, discussed in Amsler, *Corporations, Annual Survey of Texas Law*, 23 Sw. L.J. 98, 107 (1969).

¹¹⁰ *Irwin v. Prestressed Structures, Inc.*, 442 S.W.2d 406 (Tex. Civ. App.—Amarillo 1969), *error ref. n.r.e.*; see Hamilton & Shields, *supra* note 4, at 105.

¹¹¹ TEX. BUS. CORP. ACT ANN. art. 2.15(A) (1956) states that par value shares may be issued for such consideration as may be fixed by the board of directors from time to time, but at no less than par value.

¹¹² *Id.* art. 2.16(B) prohibits the issuance of stock for the promise of future services. See, e.g., *United Steel Indus., Inc. v. Manhart*, 405 S.W.2d 231 (Tex. Civ. App.—Waco 1966), *error ref. n.r.e.*

had found the plaintiff failed to use reasonable diligence in not demanding his stock prior to December 1966. As a consequence, the defendants were not estopped from asserting the limitation defense, even though the jury had also found the plaintiff believed in good faith at all times up to 1966 that he would receive his stock. Even if limitations did not run until he demanded his shares, his demand would have to be made within a reasonable time, in this case within a period coincidental with the running of the statute of limitation.¹¹³

Repurchase of Shares. The power of a Texas corporation to distribute any or all of its assets to its shareholders is limited under the TBCA, mainly for the protection of corporate creditors. During the continuing life of the corporation, shareholder distributions may take the form of cash or property dividends,¹¹⁴ distributions in partial liquidation,¹¹⁵ or the repurchase or redemption of its own shares.¹¹⁶ But all are limited primarily by the availability of certain specified surplus accounts,¹¹⁷ and none are to be made when the corporation is or would be made insolvent by the distribution.¹¹⁸ If these statutory limits are not observed, the directors responsible for their evasion can be held personally liable for the improper distributions made.¹¹⁹ But what other effects

¹¹³ The jury found that under the employment agreement the plaintiff would have the right to receive his stock within one year from the date of the agreement. Hence, his cause of action accrued in July 1960, and since his suit was not brought until 1967, it was therefore barred by the two-year statute of limitation. TEX. REV. CIV. STAT. ANN. art. 5526 (1958).

¹¹⁴ TEX. BUS. CORP. ACT ANN. arts. 2.38, 2.39 (1956).

¹¹⁵ *Id.* art. 2.40.

¹¹⁶ *Id.* arts. 2.03, 4.08.

¹¹⁷ Cash and property dividends for corporations which are not consuming asset corporations are payable only out of unreserved and unrestricted earned surplus. *Id.* art. 2.38(A)(1); consuming asset corporations may also pay out cash and property dividends in an amount not exceeding the total amount of its depletion and amortization reserves. *Id.* art. 2.39(A). Arrearages owed cumulative preferred shareholders can be satisfied out of unrestricted capital surplus if the corporation has no earned surplus at the time. *Id.* art. 2.40(B). Distributions in partial liquidation may be paid out of capital surplus or reduction surplus. *Id.* art. 2.40(A). Shares may be repurchased out of several sources, depending on the purposes or mode of authorization for the repurchase. *Id.* art. 2.03. Thus, shares may be repurchased by authorization of the board out of any unrestricted surplus or stated capital to (1) eliminate fractional shares, (2) collect or compromise a debt, (3) pay dissenting shareholders, or (4) effect the purchase or redemption of redeemable shares. *Id.* art. 2.03(B). Otherwise, the board can only authorize repurchase of shares out of unrestricted earned surplus, provided the cumulative preferences of preferred shareholders have been fully satisfied. *Id.* art. 2.03(C). Unrestricted capital or reserve surplus may be used, however, when authorized by the board and a vote of the holders of two-thirds of all shares of each class. *Id.* art. 2.03(D). Redeemable shares cannot be redeemed for an amount greater than the stated capital represented by the shares, unless the excess can be paid out of a surplus account, but in no event can they be redeemed for a price exceeding the redemptive price. *Id.* art. 4.09(A)(1), (4).

¹¹⁸ *Id.* arts. 2.03(F), 2.38(A), 2.39(A)(1), 2.40(A)(1), 2.40(B), 4.09(A)(2). Insolvency is defined in the equity sense in the TBCA as inability of a corporation to pay its debts as they become due in the usual course of business. *Id.* art. 1.02(A)(16). The bankruptcy standard of insolvency, *i.e.*, an excess of liabilities over assets, is also used in limiting repurchases of shares and dividends of consuming asset corporations. *Id.* arts. 2.03(F), 2.39(A)(1). See generally H. HENN, *supra* note 12, at 637; Hartmann & Wilson, *Payment for Repurchased Shares Under the Texas Business Corporation Act*, 26 SW. L.J. 725 (1972).

¹¹⁹ TEX. BUS. CORP. ACT ANN. arts. 2.41(A)(1), (2), (6) (1956). Only directors who vote for or assent to the proscribed actions can be held liable, and even they can avoid liability upon a showing of reliance in good faith and in the exercise of ordinary care on financial records represented or certified to be correct or upon the written opinion of an attorney for the corporation. *Id.* arts. 2.41(C), (D). Moreover, if held liable, they may seek contribution against shareholders who received illegal dividends or distributions knowing

transgressing the prescribed bounds should have been raised in an interesting case decided by the Tyler court of civil appeals, *Triumph Smokes, Inc. v. Sarlo*.¹²⁰

Two former stockholders sued Triumph to collect the principal (and presumably the unpaid interest) on non-subordinated debentures which were past due and unpaid. The debentures had been issued by formal action of the board of directors to one of the plaintiffs to "redeem"¹²¹ his holdings of both common and preferred stock and to reimburse him for a loan he had guaranteed for the corporation and to the other plaintiff to redeem his common. At the time of issuance, Triumph had no earned surplus nor did it subsequently have any. On motion for summary judgment, in which the sole issue was the validity of the stock repurchase, the plaintiffs argued that the transaction was at most ultra vires. Triumph contended, however, that the transaction violated TBCA article 2.03(C),¹²² which permits the repurchase of shares by action of the board only to the extent the corporation has unrestricted earned surplus; hence, issuing the debentures in exchange for the stock made them illegal and void. The trial court nevertheless awarded the plaintiffs summary judgment, and the Tyler court affirmed.

The appellate court regarded the question before it as essentially one of corporate power, rather than lack of capacity to exchange the shares for the debentures. Put another way, it conceived the issuance as one more properly entailing a lack of authority and not the commission of an illegal act in contravention of an express statute on the subject. Because article 2.03 empowers a corporation to repurchase its shares under prescribed circumstances,¹²³ but does not state that a repurchase in contravention of those bounds would be void, the court held that the statute creates a limitation on the permitted exercise of power and not an absolute prohibition. This interpretation is buttressed by the sanction imposed in article 2.41(A)(2)¹²⁴ for violating article 2.03, which makes directors who vote for or assent to a repurchase of shares con-

they had been made in violation of the Act. *Id.* art. 2.41(E). Shareholders who receive distribution in partial liquidation payable out of reduction surplus are subject to the director's right of contribution irrespective of their state of knowledge. *Id.* art. 2.41(A)(6).

¹²⁰ 482 S.W.2d 696 (Tex. Civ. App.—Tyler 1972), *error ref. n.r.e.*

¹²¹ Technically, common shares cannot be redeemed, since normally they will not have the liquidation preference required to make shares redeemable in Texas. TEX. BUS. CORP. ACT ANN. art. 4.09(A) (1956).

¹²² *Id.* art. 2.03(C). To the extent any of the corporation's surplus accounts are used to permit the repurchase of shares, they become restricted so long as the shares are held as treasury shares; when the shares are cancelled or disposed of the restriction is removed pro tanto as to all restricted surplus not eliminated thereby. *Id.* art. 2.03(E). Because under *id.* arts. 1.02(A)(10), (12) treasury shares are excluded from the calculation of net assets when determining the existence of surplus (defined as the excess of net assets over stated capital), thus diminishing the total amount of surplus available, there is in effect a double restriction on the use of surplus accounts so long as the reacquired shares are held in the treasury. See 1 ABA, MODEL BUS. CORP. ACT ANN. 37 (2d ed. 1971); Hackney, *The Financial Provisions of the Model Business Corporation Act*, 70 HARV. L. REV. 1357, 1392 (1957). The double restriction was inadvertently imposed in the 1950 version of the Model Business Corporation Act and was cured by a 1969 amendment that deleted the exclusion of treasury shares from the definition of net assets in § 2 of the Act. 1 ABA, MODEL BUS. CORP. ACT ANN. 37 (2d ed. 1971). One of the amendments proposed to the TBCA at the current session of the legislature would make the same change in art. 1.02(A)(10). S.B. 202, H.B. 329, 63d Legis. § 1 (1973).

¹²³ See note 117 *supra*.

¹²⁴ TEX. BUS. CORP. ACT ANN. art. 2.41(A)(2) (1956).

trary to the Act jointly and severally liable to the corporation for the amount improperly paid, since "obviously the corporation could not recover from the directors if the transaction was illegal and void."¹²⁵ Thus, the debentures were not illegally issued, but remained enforceable. Moreover, only those persons who have been injured or prejudiced by a repurchase of shares can attack its validity; the corporation cannot.

Given the posture of the case, the result was undoubtedly correct, since neither other creditors nor shareholders complained or intervened.¹²⁶ But one of the grounds of the decision, namely the preclusion of Triumph from asserting lack of capacity as a defense as set out in article 2.04(A), seems misplaced, since that provision was aimed at dispelling any notion that a corporation as a creature of the law has no ability to commit a wrongful act.¹²⁷ Rather, the corporation's act, by exceeding an imposed limit on a conferred power, was tantamount to an ultra vires transaction as delineated in article 2.04(B), and assertible only under the narrow terms spelled out in that section.¹²⁸ In that sense, the decision certainly accords with the supreme court's holding in *Whitten v. Republic National Bank*,¹²⁹ cited by the court, which regarded a similar provision which permitted a corporation to lend money to or otherwise assist its employees, but not its officers or directors, as a limitation on a power granted by the Act and not a positive prohibition. In *Whitten* the supreme court estopped the corporation's trustee in bankruptcy from asserting his claim because of benefits the corporation had received from the transaction in question. It declined, however, to pass on the applicability of article 2.04(B), despite the pertinency of that section. The Tyler court similarly failed to consider the impact of article 2.04(B). Still, the alternative ground it relied upon, *i.e.*, that a corporation may not attack the invalidity of a repurchase of its own stock, is one that is generally applied.¹³⁰

¹²⁵ 482 S.W.2d at 698.

¹²⁶ See, *e.g.*, *Medical Arts Bldg. Co. v. Southern Fin. & Dev. Co.*, 29 F.2d 966, 973 (5th Cir. 1929); *Lanpar Co. v. Stull*, 405 S.W.2d 235, 237 (Tex. Civ. App.—Waco 1966), discussed in *Pelletier*, *supra* note 4, at 152; *W.R. Case & Sons Cutlery Co. v. Folsom*, 170 S.W. 1066, 1067 (Tex. Civ. App.—Dallas 1914). See generally 1 I. HILDEBRAND, *supra* note 41, § 79; Blackstock, *A Corporation's Power To Purchase Its Own Stock and Some Related Problems*, 13 TEXAS L. REV. 442 (1935); Israels, *Limitations on the Corporate Purchase of Its Own Shares*, 22 SW. L.J. 755 (1968).

¹²⁷ "The doctrine of inherent incapacity is eliminated. From the point of view of capacity or power, in the sense of the ability to alter legal relations, a corporation possesses such power in the same measure as does an individual." Texas State Bar committee statement with respect to art. 2.04 of the TBCA. Committee Comment, 3A TEX. REV. CIV. STAT. ANN. 40 (1956); see 1 ABA, MODEL BUS. CORP. ACT ANN. § 7, at 278 (2d ed. 1971); Comment, *Ultra Vires Under the Texas Business Corporation Act*, 40 TEXAS L. REV. 677, 684 (1962).

¹²⁸ TEX. BUS. CORP. ACT ANN. art. 2.04(B) (1956). Ultra vires can only be asserted in a proceeding brought (1) by a shareholder to enjoin the doing of an ultra vires act or transfer of property, (2) by the corporation, either directly or through a legal representative or shareholder's suit, to hold officers or directors accountable for exceeding their authority, and (3) by the attorney general to dissolve or enjoin the corporation because of its ultra vires activity. Dissolution can also be sought under two unrepealed articles of title 32 for ultra vires activity unless within one year from the act the corporation formally repudiates the action and permanently discharges all persons directly or indirectly connected with the violation. TEX. REV. CIV. STAT. ANN. arts. 1349, 1351 (1962).

¹²⁹ 397 S.W.2d 415 (Tex. 1965).

¹³⁰ *E.g.*, *La Voy Supply Co. v. Young*, 84 Idaho 120, 369 P.2d 45, 49 (1962); *Lanpar Co. v. Stull*, 405 S.W.2d 235, 237 (Tex. Civ. App.—Waco 1966), *error ref. n.r.e.* See generally 7 Z. CAVITCH, *supra* note 103, § 147.04(3).

Despite the soundness of the holding, the decision leaves some intriguing questions unanswered. Should plaintiffs, as former shareholders, be permitted to withdraw assets from what appears to be an insolvent firm by having their debentures paid as creditors at the expense of other creditors? Had other creditors, especially those whose debts were created prior to the exchange, complained, there seems little question that plaintiffs' claims either would have been subordinated¹³¹ or they could be held liable to other creditors for the value of assets received.¹³² Assuming the transaction was *ultra vires*, could a shareholder intervene to prevent the corporation from paying off the debentures,¹³³ especially with respect to the plaintiff who apparently had conferred no benefit on the corporation? The debentures themselves were a type of debt security similar to a bond; would they not come under the constitutional provision forbidding either stocks or *bonds* being issued except for money paid, labor done or property actually received, and stating that "all fictitious increase of stock or *indebtedness* shall be void"?¹³⁴ Can debentures exchanged for stock under circumstances which violate article 2.03(C) because of the lack of earned surplus, or possibly article 2.03(F),¹³⁵ be said to have been issued for valid consideration as required by the Texas Constitution? As such, they may be just as watered as shares that have been issued for no, or failed, consideration. Since watering under those circumstances can result in the issuance being set aside, even, under some conditions, by the corporation,¹³⁶

¹³¹ *E.g.*, *McConnell v. Estate of Butler*, 402 F.2d 362, 367 (9th Cir. 1968) (subordination of claims of holders of debentures given in exchange for stock to claims of general creditors when corporation bankrupt at time for payment of debentures); *In re Trimble Co.*, 339 F.2d 838, 845 (3d Cir. 1964); *Robinson v. Wangeman*, 75 F.2d 756, 758 (5th Cir. 1935) (Texas corporation; notes given for stock subordinated to claims of other creditors); *First Trust Co. v. Illinois C.R.R.*, 256 F. 830, 831 (8th Cir. 1919) (subordination of notes and bonds given for stock); *In re Fechheimer Fishel Co.*, 212 F. 357, 363 (2d Cir. 1914), *cert. denied*, 234 U.S. 760 (1914). *But cf.* *Wolf v. Heidritter Lumber Co.*, 112 N.J. Eq. 34, 163 A. 190 (Ch. 1932). *See generally* 7 Z. CAVITCH, *supra* note 103, § 148.05[2]; 1 G. HORNSTEIN, *supra* note 45, § 496, at 622; Blackstock, *supra* note 126, at 447; Herwitz, *Installment Repurchase of Stock: Surplus Limitations*, 79 HARV. L. REV. 303 (1965); Annot., 4 A.L.R. FED. 654, 662, 664 (1970) (stockholder converting or selling stock to corporation as creditor in bankruptcy); Annot., 47 A.L.R.2d 758 (1956) (rights of creditor of corporation with respect to its purchase or acquisition of its own stock).

¹³² *See, e.g.*, *A.R. Clark Inv. Co. v. Green*, 375 S.W.2d 425, 436-37 (Tex. 1964); *Burton Mill & Cabinet Works, Inc. v. Truemper*, 422 S.W.2d 825 (Tex. Civ. App.—Waco 1967), *error ref. n.r.e., discussed in* Amsler, *supra* note 109, at 99.

¹³³ *See* *Inter-Continental Corp. v. Moody*, 411 S.W.2d 578 (Tex. Civ. App.—Houston 1966), *error, ref. n.r.e., discussed in* Amsler, *Corporations, Annual Survey of Texas Law*, 22 SW. L.J. 59, 72-74 (1968), permitting a stockholder to intervene in an action on a corporate note to enjoin its payment as an *ultra vires* transaction, since the stockholder could have initiated an action under TEX. BUS. CORP. ACT ANN. art. 2.04(B) (1). *See also* Trotti, *Should an Existing Corporation Adopt the Act?—Panel Discussion*, in PROCEEDINGS, TEXAS BUSINESS CORPORATION ACT INSTITUTE 15, 16 (1955), reprinted in 3A TEX. REV. CIV. STAT. ANN. 455, 456 (1956); Comment, *Ultra Vires Under the Texas Business Corporation Act*, 40 TEXAS L. REV. 677, 693 (1962).

¹³⁴ TEX. CONST. art. XII, § 6 (emphasis added). The constitutional language is repeated in part in art. 2.06(A) of the Texas Miscellaneous Corporation Laws Act, although in the absence of fraud in the transaction, the judgment of the board or shareholders as to the value of consideration received for any indebtedness is conclusive. TEX. REV. CIV. STAT. ANN. art. 1302-2.06(A) (1962); *see* Amsler, *supra* note 133, at 74.

¹³⁵ TEX. BUS. CORP. ACT ANN. art. 2.03(F) (1956) forbids repurchase of shares either when there is reasonable grounds for believing the corporation is insolvent or would be made so by the purchase, or if, after the purchase, the fair value of the total assets will be less than the total amount of debts.

¹³⁶ *See, e.g.*, *Vermilion Parish Peat Co. v. Green Belt Peat Moss Co.*, 465 S.W.2d 950

were not the debentures in *Triumph Smokes* subject to the same attack? On that basis perhaps Triumph would have had a better ground for resisting enforcement of the debentures, although admittedly older case law dealing with the status of watered shares might still support the Tyler court's disposition of the case.¹³⁷ The ultimate answers, of course, must wait for a better case to be appealed. In the meantime, *Triumph Smokes* seemingly puts another nail in the ultra vires coffin.

Debentures. In another case involving debentures,¹³⁸ but decided on a different ground, a debenture holder succeeded, after a second effort,¹³⁹ in recovering on a debenture which had been in default since 1961 in an action originally brought in 1967. The corporation quite naturally pleaded the four-year statute of limitation,¹⁴⁰ but was held estopped to assert the defense because of the plaintiff's reliance on representations that had been made to her by the defendant's chief executive officer. The jury found that in November 1964 the officer had asked plaintiff not to bring suit on her debenture while another suit by debenture holders was pending, and assured her that if she would not join in their suit, her debenture would be paid on the same basis the debenture holders bringing suit would receive. They were ultimately paid in full, but she was not; hence her suit.

Informal Dividends. In *English v. Ramo, Inc.*¹⁴¹ a significant part of the opinion turned on the characterization of withdrawals that were made from an acquired corporation, Red Ball Motor Freight, Inc., by its parent, Ramo, Inc., shortly after all of Red Ball's shares had been sold to Ramo by Red Ball's family owners. If the withdrawals were advances or loans to Ramo, they were permissible; on the other hand, if they were in effect dividends, they contravened the terms of an agreement between Red Ball's former owners and Ramo that secured purchase-money notes given the owners as partial payment for their shares. Under the agreement, Ramo could only have Red Ball declare and pay cash dividends out of profits accruing after the date of the agreement, and dividends could not be declared or paid that would reduce the continued capital and surplus of Red Ball and its subsidiaries below their aggregate amount as of a specified date. When the contract was signed Red

(Tex. Civ. App.—Dallas 1971), *error ref. n.r.e.*, noted in Lebowitz, *supra* note 4, at 107; *United Steel Indus., Inc. v. Manhart*, 405 S.W.2d 231 (Tex. Civ. App.—Waco 1966), *error ref. n.r.e.*; *cf. Fulton v. Abramson*, 369 S.W.2d 815 (Tex. Civ. App.—Dallas 1963).

¹³⁷ See, e.g., *Washer v. Smyer*, 109 Tex. 398, 211 S.W. 985 (1919); *Hamilton-Turner Grocery Co. v. Hander*, 299 S.W. 848 (Tex. Comm'n App. 1927), *judgment adopted*; *Smith v. Ideal Laundry Co.*, 286 S.W. 285 (Tex. Civ. App.—San Antonio 1926), *error dismissed*; *Commonwealth Bonding & Cas. Ins. Co. v. Hill*, 184 S.W. 247 (Tex. Civ. App.—Amarillo 1915); *Houston Fire & Marine Ins. Co. v. Swain*, 114 S.W. 149 (Tex. Civ. App. 1908); *cf. Thompson v. First State Bank*, 109 Tex. 419, 211 S.W. 977 (1919).

¹³⁸ *Lanpar Co. v. Stanfield*, 474 S.W.2d 753 (Tex. Civ. App.—Waco 1971), *error ref. n.r.e.*

¹³⁹ The plaintiff had originally obtained a summary judgment in her favor, but it was reversed because issues of fact existed with respect to her ownership of the debenture involved, whether there had been acceleration of maturity, and the reasonableness of attorney's fees for collection. *Lanpar Co. v. Stanfield*, 451 S.W.2d 254 (Tex. Civ. App.—Dallas 1970).

¹⁴⁰ TEX. REV. CIV. STAT. ANN. art. 5527 (1958).

¹⁴¹ 474 S.W.2d 600 (Tex. Civ. App.—Dallas 1971), *error granted*; see notes 19, 20, 104, 105 *supra*, and accompanying text.

Ball had undistributed profits of more than 2,250,000 dollars. On the next business day, Ramo withdrew 1,500,000 dollars in cash from Red Ball's account. The withdrawal was not formally authorized by Red Ball's directors, nor did Ramo give Red Ball a note or agree to pay it interest. The withdrawal was noted on Red Ball's books as an "advance receivable" from Ramo and on Ramo's books as an "advance payable to subsidiary." Later advances made in the same fashion raised the sum withdrawn to 2,272,375 dollars. As a result, Red Ball had to borrow funds for working capital, and subsequently operated at a loss.

Although Ramo argued that the advances were but inter-company loans and, absent a formal declaration, could not be considered dividends, the Dallas court of civil appeals ruled that as a matter of law the withdrawals were dividends that contravened the security agreement. The jury's finding that Ramo had no intention of repaying the transferred funds was amply supported by the evidence, and it was clear the withdrawals resulted in precisely the type of financial weakness the dividend limitation was designed to prevent. Further, Ramo's use of Red Ball's funds without interest would also be deemed equivalent to a dividend, since even if the advances were loans, Ramo had the benefit of interest on Red Ball's money. Based on similar holdings concerning constructive dividends in tax law¹⁴² and in comparable non-tax situations,¹⁴³ the court ruled "that regardless of the form of the transaction, a distribution of corporate funds to a controlling stockholder because of its stock ownership and for its sole benefit, and repayable at its sole discretion, is a dividend insofar as the rights of creditors are concerned."¹⁴⁴ The Texas Supreme Court has granted error in the case,¹⁴⁵ but on the facts of the case, the Dallas court's holding is a well reasoned statement of the law concerning informally declared dividends and is consistent with the basic purpose of the security agreement before it.

V. OTHER SUBSTANTIVE DECISIONS

Securities Regulation. Two of the cases decided during the survey period dealt with the Texas Securities Act. One was a federal decision which used the three-year limitation on civil action set out in section 33 of the Act to

¹⁴² The courts have held in numerous tax cases that withdrawals of corporate funds in the form of loans or for other personal purposes were in fact devices designed to conceal the distribution of earnings and profits taxable as dividends. The critical question is whether, at the time the withdrawal is made, there was any intent it be repaid. *See, e.g.,* Bayou Verret Land Co. v. Commissioner, 450 F.2d 850, 859 (5th Cir. 1971); United States v. Smith, 418 F.2d 589, 593 (5th Cir. 1969); Ogdon Co. v. Commissioner, 412 F.2d 223, 225 (1st Cir. 1969). *See generally* B. BITTKER & J. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS § 7.05 (3d ed. 1971); J. CHOMMIE, LAW OF FEDERAL INCOME TAXATION § 182 (1968).

¹⁴³ *See, e.g.,* Smith v. Moore, 199 F. 689, 697 (9th Cir. 1912) (withdrawals by principal stockholder carried on corporate books as debit items); Oilwell Chem. & Materials Co. v. Petroleum Supply Co., 64 Cal. App. 2d 367, 148 P.2d 720 (1944); Central of Ga. Ry. v. Central Trust Co., 135 Ga. 472, 69 S.E. 708, 719 (1910) (earnings of wholly owned subsidiary deposited with parent deemed dividend income of parent in measuring amount available for interest on parent's income bonds). *See generally* R. BAKER & W. CARY, CASES AND MATERIALS ON CORPORATIONS 1348 (3d ed. 1959); H. BALLENTINE, *supra* note 49, § 239.

¹⁴⁴ 474 S.W.2d at 605.

¹⁴⁵ 16 Tex. Sup. Ct. J. 420 (1972).

determine limitation for a 10b-5 action. The other construed the procedure for judicial review of the Texas securities commissioner's orders, and constituted a setback for administrative enforcement of the Act.

In *Richardson v. Salinas*¹⁴⁶ the plaintiff brought a rule 10b-5 action¹⁴⁷ in a Texas federal district court in February 1971 to recover the balance of the purchase price of stock which the defendant had agreed to buy in January 1969. The plaintiff claimed the defendant never intended to pay the full amount for the stock and his failure to do so amounted to a material omission or fraudulent course of business under rule 10b-5. The defendant moved to dismiss, primarily on the ground that the plaintiff's action was barred by the Texas two-year statute of limitation,¹⁴⁸ but also for failure to state a claim upon which relief could be granted. On the limitation issue, the plaintiff contended the three-year period prescribed in section 33 of the Texas Securities Act¹⁴⁹ should prevail.

Because section 10(b) of the Securities Exchange Act of 1934¹⁵⁰ contains no statute of limitation, limitation periods prescribed by state law are generally used.¹⁵¹ When the state statutes vary, the federal court must then consider which statute "best effectuates the federal policy at issue."¹⁵² Texas has two statutes which provide a civil remedy for fraudulent stock transactions: section 33 of the Texas Securities Act which permits both rescission and damages,¹⁵³ and section 27.01 of the Texas Business and Commerce Code which creates a specific damage action for common law fraud.¹⁵⁴ Section 33 contains

¹⁴⁶ 336 F. Supp. 997 (N.D. Tex. 1972).

¹⁴⁷ 17 C.F.R. § 240.10b-5 (1972). See generally A. BROMBERG, SECURITIES LAW: FRAUD (1971); W. PAINTER, FEDERAL REGULATION OF INSIDER TRADING (1968).

¹⁴⁸ TEX. REV. CIV. STAT. ANN. art. 5526 (1958).

¹⁴⁹ *Id.* art. 581-33(c) (1964).

¹⁵⁰ 15 U.S.C. § 78j(b) (1970).

¹⁵¹ *Parrent v. Midwest Rug Mills, Inc.*, 455 F.2d 123, 125 (7th Cir. 1972); *Vanderboom v. Sexton*, 422 F.2d 1233, 1239 (8th Cir. 1970); *Esplin v. Hirschi*, 402 F.2d 94, 101 (10th Cir. 1968); *Myzel v. Fields*, 386 F.2d 718, 742 (8th Cir. 1967); *Janigan v. Taylor*, 344 F.2d 781, 783 (1st Cir. 1965); *Collins v. Rukin*, 342 F. Supp. 1282, 1292 (D. Mass. 1972); *Dyer v. Easter Trust & Banking Co.*, 336 F. Supp. 890, 905 (D. Me. 1971); *Trussell v. United Underwriters Ltd.*, 228 F. Supp. 757, 775 (D. Colo. 1964); *Tobacco & Allied Stocks, Inc. v. Transamerica Corp.*, 143 F. Supp. 323, 328 (D. Del. 1956), *aff'd*, 244 F.2d 902 (3d Cir. 1957); see *Saemann v. Everest & Jennings, Int'l*, 343 F. Supp. 457, 460 (N.D. Ill. 1972); cf. *UAW v. Hoosier Cardinal Corp.*, 383 U.S. 696, 703-04 (1966); *Holmberg v. Armbricht*, 327 U.S. 392, 395 (1946). See 1 A. BROMBERG, *supra* note 147, § 2.5(1).

¹⁵² *Charney v. Thomas*, 372 F.2d 97, 100 (6th Cir. 1967).

¹⁵³ TEX. REV. CIV. STAT. ANN. art. 581-33(A) (1964). A purchaser who has an action under the statute may seek either to rescind by tendering the security to recover the amount paid and interest at 6% per annum from the date of payment, less any income received from the security, or to recover damages if he no longer owns the security. Damages are defined as the amount that would be recoverable upon a tender less the value received upon disposition and interest at the same rate on the amount received. See Comment by Committee on Securities and Investment Banking of the Section on Corporation, Banking and Business Law of the State Bar of Texas, 1B TEX. REV. CIV. STAT. ANN. 70 (1964); Bordwine, *Civil Remedies Under the Texas Securities Laws*, 8 HOUSTON L. REV. 657, 662 (1971); Meer, *A New Look at the Texas Securities Act*, 43 TEXAS L. REV. 680, 701 (1965).

¹⁵⁴ TEX. BUS. & COMM. CODE § 27.01 (1968) permits recovery of damages for fraud in a transaction involving stock in a corporation. Damages are measured by the difference between the value of the stock as represented and its actual value when delivered. In addition, when the misrepresentations have been willfully made or a person knowingly benefits from a false representation or promise, exemplary damages in an amount not to exceed twice the actual damages sustained may be recovered. The actionable fraud statute is limited to fraud in real estate or stock transactions. As to securities law fraud, it is both narrower and broader than the Texas Securities Act § 33 remedies. It is more restrictive in being limited to transactions involving "stock in a corporation or joint stock company." Thus,

its own limitation period: three years after the contract of sale or after the purchaser in the exercise of ordinary care should have discovered the fraud. Section 27.01 does not, and although Texas has no statute which specifically prescribes the period of limitation for fraud, article 5526, the general two-year statute, has been applied to fraud actions and controls suits brought under section 27.01.¹⁵⁵

In making his decision, District Judge Hill felt two things should be considered: (1) which of the two fraud action statutes comes closer in purpose to rule 10b-5, and (2) which limitation period best effectuates the rule's purpose. In response to the first consideration, he believed section 33, although not identical in language¹⁵⁶ to rule 10b-5 and providing a remedy only for buyers and not buyers and sellers, was nearer in purpose than the actionable fraud statute. Judge Hill noted that only two courts had been directly confronted with a choice between a blue sky law type of limitation and a common-law fraud one and the results had been mixed.¹⁵⁷ However, dictum in a Fifth Circuit case¹⁵⁸ indicated the limitation period in a rule 10b-5 action should in no case be shorter than for a similar common-law action. Since section 33 would extend, not shorten the limitation period, and article 5526 was not specifically directed at fraud actions, Judge Hill concluded the blue sky limitation was the natural choice for a rule 10b-5 action¹⁵⁹ and overruled the motion to dismiss.¹⁶⁰

not only are conventional corporate securities such as bonds and debentures excluded, but so are the many forms of investment contracts or securities issued by non-corporate organizations that are covered in the broad definition of "security" or "securities" in the Texas Securities Act. TEX. REV. CIV. STAT. ANN. art. 581-4(A) (1964). It is more expansive, however, in that its scope includes purchasers as well as sellers. Chandler v. Butler, 284 S.W.2d 388 (Tex. Civ. App.—Texarkana 1955); see Bordwine, *supra* note 153, at 665.

¹⁵⁵ TEX. REV. CIV. STAT. ANN. art. 5526 (1958); see White v. Bond, 362 S.W.2d 295, 296 (Tex. 1962); Finger v. Morris, 468 S.W.2d 572, 578 (Tex. Civ. App.—Houston [14th Dist.] 1971), *error ref. n.r.e.*

¹⁵⁶ Section 33(A) creates a civil cause of action for offers and sales which entail either a violation of certain other sections of the Act, *e.g.*, registration requirements, or the making of "any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made not misleading (when the person buying the security does not know of the untruth or omission, and who in the exercise of reasonable care could not have known of the untruth or omission)." TEX. REV. CIV. STAT. ANN. art. 581-33(A) (2) (1964). The section is derived from Uniform Securities Act § 410, which in turn is taken almost verbatim from § 12(2) of the Securities Act of 1933, 15 U.S.C. § 771(2) (1970). L. LOSS & E. COWETT, BLUE SKY LAW 390 (1958). Section 12(2) of the 1933 Act is quite similar in terminology to § 17(a)(2) of the same Act, 15 U.S.C. § 77g(2) (1970), and § 17(a) in turn provided the source for rule 10b-5. 3 L. LOSS, SECURITIES REGULATION 1427 (2d ed. 1961); see Lebowitz, *supra* note 4, at 116 n.163.

¹⁵⁷ Compare Vanderboom v. Sexton, 422 F.2d 1233 (8th Cir.), *cert. denied*, 400 U.S. 852 (1970), with Charney v. Thomas, 372 F.2d 97 (6th Cir. 1967).

¹⁵⁸ Azalea Meats, Inc. v. Muscat, 386 F.2d 5, 8 (5th Cir. 1967).

¹⁵⁹ Accord, Parrent v. Midwest Rug Mills, Inc., 455 F.2d 123 (7th Cir. 1972); Vanderboom v. Sexton, 422 F.2d 1233 (8th Cir.), *cert. denied*, 400 U.S. 852 (1970); Dyer v. Easter Trust & Banking Co., 336 F. Supp. 890, 906 (D. Me. 1971); Batchelor v. Legg & Co., 52 F.R.D. 553, 558 (D. Md. 1971). *Contra*, Douglass v. Glenn E. Hinton Inv., Inc., 440 F.2d 912 (9th Cir. 1971); Charney v. Thomas, 372 F.2d 97 (6th Cir. 1967); Denny v. Performance Systems, Inc., [1971-1972 Transfer Binder] CCH FED. SEC. L. REP. ¶ 93,387 (M.D. Tenn. 1971); Geo. H. McFadden & Bro., Inc. v. Home-Stake Prod. Co., 295 F. Supp. 587, 589 (N.D. Okla. 1965); *cf.* Collins v. Rukin, 342 F. Supp. 1282 (D. Mass. 1972) (either general or blue sky period can be applied). *But cf.* Aboussi v. Aboussi, 441 F.2d 150, 156 (5th Cir. 1971) (limitations for fraud action in Texas applied, but agreed to by both parties). The commentators agree the blue sky law period of limitation should be used for rule 10b-5 actions, and seem surprised the choice had not been made sooner. 1 A. BROMBERG, *supra* note 147, at 41 n.105; 6 L. LOSS, *supra* note 156, at 3902.

¹⁶⁰ Although feeling that the plaintiff might have alleged no more than a suit for breach

In *Holladay v. Intercontinental Industries, Inc.*¹⁶¹ the Austin court of civil appeals ruled that an issuer whose securities had been subjected to an order of the Texas securities commissioner revoking secondary trading could appeal the order on a de novo basis even though no provision of the Texas Securities Act specifically permits the order to be judicially reviewed.

Section 5(O) of the Texas Act¹⁶² exempts transactions by registered dealers in certain securities from the registration requirements of the Act. In general, such securities must be outstanding in the hands of the public, be offered at a price reasonably related to the market price, not be subject to judicial or administrative orders preventing their sale, and have been registered under the Act or specified information about the issuer must appear in a recognized securities manual. Since no part of the proceeds of such sales are to be paid to the issuer either directly or indirectly, the exemption is basically one for secondary trading in the securities market. The exemption may be prohibited, revoked, or suspended, however, by an order of the securities commissioner whenever he has reasonable cause to believe the issuer's plan of business, or the securities themselves, or their sale would tend to work a fraud or deceit on any purchaser. The order is to be subject to review in an administrative hearing before the commissioner, as provided in section 24.¹⁶³ But nothing is stated about further review.

In *Holladay*, after the commissioner had extended an order revoking secondary trading in Intercontinental's securities, Intercontinental sought review in the district court in Travis County under section 27 of the Act, which permits "any dealer, salesman or applicant aggrieved by any decision of the Commissioner" to appeal to that court; moreover, all appeals to the court are to be tried de novo "as that term is used in an appeal from Justice of the Peace Court to a County Court, as if there had been no previous determination or hearing on the matters in controversy, and under no circumstances shall the substantial evidence rule as interpreted by the courts of Texas ever be applied to appeals taken under this Act."¹⁶⁴ Nevertheless, the commissioner asked that the case be tried under the substantial evidence rule and, when the trial court ruled it must be tried de novo, the commissioner declined to amend his pleadings or assume the burden of proof. The trial court, therefore, awarded judgment to Intercontinental.

The commissioner contended on appeal that the sole mode of review for orders suspending secondary trading is that prescribed in section 5(O), *i.e.*, an administrative hearing before himself. Although there is respectable authority that even without statutory authorization administrative orders are subject to judicial review,¹⁶⁵ the Austin court chose to find such right of review by an

of contract, rather than fraud, and that his claim was, therefore, subject to dismissal under the authority of *Seward v. Hammond*, 8 F.R.D. 457 (D. Mass. 1948), the court agreed with the holding in *A.T. Brod & Co. v. Perlow*, 375 F.2d 393 (2d Cir. 1967), that the interests of justice would be better served by further development of the case, rather than dismissing for failure to state a claim upon which relief could be granted.

¹⁶¹ 476 S.W.2d 779 (Tex. Civ. App.—Austin 1972), *error ref. n.r.e.*

¹⁶² TEX. REV. CIV. STAT. ANN. art. 581-5(O) (1964).

¹⁶³ *Id.* art. 581-24.

¹⁶⁴ *Id.* art. 581-27.

¹⁶⁵ *Chemical Bank & Trust Co. v. Falkner*, 369 S.W.2d 427 (Tex. 1963); *Brazosport Sav. & Loan Ass'n v. American Sav. & Loan Ass'n*, 161 Tex. 543, 342 S.W.2d 747 (1961).

expansive interpretation of the last paragraph of section 5(O) in which both administrative and judicial review are provided for an order revoking or suspending recognition of securities manuals others than those named in the statute. In the face of language in that paragraph which clearly limits judicial review to orders dealing with recognition or not of manuals, the court rationalized that not to extend such review to the suspension of trading provisions in the remainder of 5(O) would be absurd, especially since the information contained in the manual could be obtained from alternative sources.

On the issue of scope of review, the court agreed with the trial court that it would have to be by a *de novo* trial as stated in section 27. It rejected the commissioner's line of argument, seemingly based on constitutional grounds that section 27 improperly delegates purely administrative functions involving public policy to the courts. The commissioner argued that the secondary trading exemption is a privilege and not a property right and a determination of its availability is an administrative matter, subject to review only under the substantial evidence rule. Further, it was argued that section 27 has the effect of presenting to the court a legislative question, which it cannot consider under the separation of powers doctrine. The court held that once the secondary trading privilege had been granted it could not be taken away without due process of law. Interestingly, the court refused to hold section 5(O) unconstitutional for not providing for a stay of the commissioner's suspension order. The issue, the court said, was not whether the administrative action called for by the Act involves public policy, but rather its effect on the parties most immediately concerned. Resolving that issue is not a matter of legislation, but one of determining liabilities as they stand on the facts. Hence, a judicial matter is presented that can be tried *de novo*.

With all due deference to the court and its concern for the individual issuer, its reading of the Texas Securities Act and the underlying objective of that legislation to protect the investing public seems quite myopic.¹⁶⁶ Given the nature of securities fraud and the brief period of time within which investors can be gulled by covert manipulation of stock prices in thin markets, there is need for quick action by knowledgeable administrators to prevent fraud and deceit. It is equally necessary that review of that action be as expeditious as possible. Substantial weight should be given to the reasons that motivated the administrator in exercising this infrequently used power, so that the enforcement of the Act will not be delayed by protracted litigation, which requires the case be completely developed anew. As a result of the decision, the commissioner and his staff often will be forced to continue their investigation and procurement of evidence against potential violators of the Act long after an order has been issued, while waiting for the possible trial *de novo* on appeal. With a small and overworked staff, the securities agency's effectiveness in protecting public investors will definitely be decreased.

On the other side of the coin, there is, of course, the need for protection

¹⁶⁶ *E.g.*, *Kadane v. Clark*, 135 Tex. 496, 501, 143 S.W.2d 197, 199 (1940) ("Clearly the outstanding purpose of this Act is the protection of the public . . . from fraud and imposition by those engaged in selling worthless securities"); *see Lebowitz, supra* note 4, at 115 n.159.

against administrative arbitrariness. The court was no doubt right in its instinctive feeling that an order suspending secondary trading privileges should be just as reviewable in court as others issued by the securities commissioner. Yet that scarcely justifies its emendation of the Act to fit the result it wanted. The court not only provided judicial appeal where the statute allowed only an administrative hearing; it brought the issuer within the operative language of section 27 which permits an appeal de novo by "any dealer, salesman or applicant" by regarding the term "dealer" as broad enough to include the issuer "which was dealing in its own stock,"¹⁶⁷ without considering whether its definition accorded with that given in section 4(C).¹⁶⁸ Section 4(C) expressly states that the term "dealer" does not include an issuer if the transaction in question is exempt under section 5 of the Act. Moreover, although not discussed in the opinion, the court seemed to allow the judicial appeal under section 27 without first requiring the section 24 administrative hearing provided in the very paragraph of section 5(O) which permits revocation of secondary trading orders.

The court's basic problem was the same that faces everyone who attempts to reconcile the varied terminology¹⁶⁹ and sometimes inexplicable hiatuses which characterize the Texas Securities Act.¹⁷⁰ It recognized these difficulties in the beginning of its opinion by reiterating the supreme court's candid observation that the Act "considered as a whole, is something less than a model of lucidity in legislative drafting."¹⁷¹ The solution clearly lies with the legislature. But since complete revision of the Act seems unlikely in the foreseeable future,¹⁷² the next best thing would be a twofold improvement: (1) individual amendments to deal with specific inconsistencies when brought to light by opinions such as *Holladay* and *Dempsey-Tegeler*; (2) elimination of the primitive and largely irrational de novo appeal of administrative decisions either by a direct amendment of section 27 or by adoption of the badly needed Texas Administrative Procedure Act.¹⁷³

Fiduciary Duties. The fiduciary duties of officers and directors do not necessarily end when the corporate enterprise terminates. Both under statutory¹⁷⁴

¹⁶⁷ 476 S.W.2d at 781.

¹⁶⁸ TEX. REV. CIV. STAT. ANN. art. 581-4(C) (1964).

¹⁶⁹ See Lebowitz, *supra* note 4, at 114 n.151.

¹⁷⁰ *Id.* at 120-21.

¹⁷¹ *Flowers v. Dempsey-Tegeler & Co.*, 472 S.W.2d 112, 114 (Tex. 1971), *discussed in* Lebowitz, *supra* note 4, at 112-16.

¹⁷² Lebowitz, *supra* note 4, at 121 n.184.

¹⁷³ An Administrative Procedure Act has been proposed for enactment at the current session of the legislature. Among its provisions is a change in the present law relating to appeals from agency action by having judicial review based on the proceedings before the agency to determine whether the agency exceeded its statutory authority and if its decision is supported by substantial evidence. Hatchell, *Administrative Procedure Act*, 35 TEX. B.J. 1119 (1972); see Reavley, *Substantial Evidence and Insubstantial Review in Texas*, 23 SW. L.J. 239, 250-55 (1969).

¹⁷⁴ In the exercise of powers granted to wind up corporate affairs during the period of limited survival after dissolution, "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." TEX. REV. CIV. STAT. ANN. art. 1302-2.07(B) (1962). See also TEX. BUS. CORP. ACT ANN. art. 2.41(A)(3) (1956) (directors jointly

and common-law rules,¹⁷⁵ they remain accountable to creditors and shareholders for corporate assets that remain in their hands after dissolution and for the manner in which they conduct the process of liquidation. And when the corporation is a closely held one so that the relationship among the shareholder-officer-directors is virtually that of a partnership or joint venture, there is all the more reason to require fair dealing by those who wind up the corporation's affairs, by obvious analogy to partnership principles.¹⁷⁶

In *Graham v. Turner*¹⁷⁷ the Waco court of civil appeals had an opportunity to apply the fiducial standard just stated, but the results were mixed. Turner brought an action against Graham to establish fifty percent ownership in a dissolved corporation and that a balance of slightly over 100,000 dollars was due him as fifty percent of the proceeds of the sale of the corporation's assets upon dissolution. He also asked for exemplary damages on the theory Graham's conduct was a wanton, willful, and malicious fraud on him, that a constructive trust be imposed on properties Graham acquired with some of the proceeds, and for an accounting for certain gravel royalties belonging to the corporation that Graham obtained as part of the dissolution. Although Graham contended throughout the case that Turner was only a corporate employee owning but one share of stock, the jury found there had been an implied agreement each would own a fifty percent interest in the corporation and that the net proceeds of the sale on dissolution would be shared equally. Based on the jury's other findings, the trial court awarded Turner 81,128.63 dollars in actual damages (the amount sought less 20,000 dollars Turner had already received), 18,395.64 dollars in interest, and 50,000 dollars in exemplary damages. The trial court also granted the other relief Turner sought.

On appeal, the Waco court determined the action was timely, ruling the four-year statute of limitation in article 5529¹⁷⁸ would apply to a suit for breach of a fiduciary relationship and that in the case of dissolution, the shareholder's action for his distributive share would not accrue or limitation begin to run until all corporate debts and obligations had been paid.¹⁷⁹ The court

and severally liable to corporation for liquidating distributions made to shareholders without payment of or provision for corporate debts, obligations, and liabilities).

¹⁷⁵ *E.g.*, *Waggoner v. Herring-Showers Lumber Co.*, 120 Tex. 605, 615, 40 S.W.2d 1, 5 (1931); *Wortham v. Lachman-Rose Co.*, 440 S.W.2d 351, 353 (Tex. Civ. App.—Houston [1st Dist.] 1969); *First Trust Co. v. Good Land Lumber Co.*, 297 S.W.2d 312, 315 (Tex. Civ. App.—Waco 1956); *see* *Evans v. Winkler*, 388 S.W.2d 265, 270 (Tex. Civ. App.—Corpus Christi 1965), *error ref. n.r.e.* *See generally* 19 AM. JUR. 2D *Corporations* § 1682, at 1025 (1965); 16A W. FLETCHER, *supra* note 37, §§ 8186, 8188; H. HENN, *supra* note 12, at 816.

¹⁷⁶ *See, e.g.*, *Johnson v. Peckham*, 132 Tex. 148, 152, 120 S.W.2d 786, 787 (1938); *Morgan v. Arnold*, 441 S.W.2d 897, 905 (Tex. Civ. App.—Dallas 1969), *error ref. n.r.e.* Under § 21(1) of the Texas Uniform Partnership Act a partner is accountable as a fiduciary for any profits derived by him without the consent of his other partners out of transactions connected with the liquidation of the partnership or from any use by him of its property. TEX. REV. CIV. STAT. ANN. art. 6132b, § 21(1) (1962). *See generally* A. BROMBERG, CRANE AND BROMBERG ON PARTNERSHIP 389 (1968); Hamilton, *supra* note 4, at 104.

¹⁷⁷ 472 S.W.2d 831 (Tex. Civ. App.—Waco 1971).

¹⁷⁸ TEX. REV. CIV. STAT. ANN. art. 5529 (1958); *see* *Greenspun v. Greenspun*, 145 Tex. 374, 198 S.W.2d 82 (1946); *Yeaman v. Galveston City Co.*, 106 Tex. 389, 167 S.W. 710 (1914); *cf.* *Peek v. Berry*, 143 Tex. 294, 184 S.W.2d 272 (1944).

¹⁷⁹ Before articles of dissolution can be filed, the corporation after collecting its assets must pay or make provision for all its creditors before any distributions in liquidation can be made to shareholders; thus, only after creditors have been taken care of will shareholders

upheld the jury's findings that Turner had placed his trust and confidence in Graham in handling the business and agreed that Graham had breached his fiduciary duty by the manner in which he handled the proceeds realized from the dissolution and sale. It, therefore, affirmed that part of the judgment awarding Turner his actual damages and interest and imposing the constructive trust.

The court refused, however, to permit recovery of the fifty percent ownership in the gravel royalty interests or of the exemplary damages Turner had been awarded. As to the former, it ruled that their value had been included in the jury's finding of actual damages. Yet the facts showed the royalty rights had been obtained by the corporation as part of the sale of its assets but then had been assigned to Graham individually. And, while the facts stated are not clear on the matter, it also appears the actual damages Turner received represented his shares of the proceeds of the assets sold on dissolution and did not reflect the royalty rights taken over by Graham.

On the issue of exemplary damages, the court applied the conventional rule that such damages cannot be awarded for breach of contract if not accompanied by a tort, even where the contract is intentionally breached.¹⁸⁰ It reasoned shareholder's rights arise out of a contractual relation in which the corporation acquires and holds the shareholder's investment under express recognition of his right and for a specific purpose. But given the fiducial nature of Graham's relationship to Turner and the jury's findings that Graham had acted with malice in the distribution of the proceeds on dissolution, the holding flies squarely in the face of a contrary ruling in *Holloway v. International Bankers Life Insurance Co.*¹⁸¹ In *Holloway*, which the Waco court did not mention, the Texas Supreme Court expressly permitted recovery of exemplary damages, in an action against former directors and officers for appropriating a corporate opportunity. It limited the contract rule on which the Waco court relied to those situations where an actual, as distinguished from a fictitious, contract is breached. It considered an action for breach of fiduciary duties as one arising in equity but analogous to situations at common law when a plaintiff is permitted to sue either in tort or in assumpsit on a quasi-contract when an act has been willfully, maliciously, or fraudulently done. The supreme court further said:

In the case at bar, the plaintiff corporation has elected to sue for the profits gained by the defendants in breach of their duties as fiduciaries. The acts of the defendants supporting the recovery are acts which equity considers to be wilful and fraudulent, regardless of what may have been the actual motives of the defendants; here, of course, the jury has found that the defendants acted with malice. . . . The remedy elected by plaintiff should not preclude the recovery of exemplary damages It is consistent with equitable principles

become legally entitled to their distributive shares. See TEX. BUS. CORP. ACT ANN. art. 6.04(A)(3) (Supp. 1972).

¹⁸⁰ E.g., *A. L. Carter Lumber Co. v. Saide*, 140 Tex. 523, 168 S.W.2d 629 (1943).

¹⁸¹ 368 S.W.2d 567 (Tex. 1963), discussed in Lebowitz, *Recent Decisions on Fiduciary Duties to Corporations*, 2 BULL. OF SECTION ON CORPORATION, BANKING & BUSINESS LAW, May 1963, at 4; accord, *Charles v. Epperson & Co.*, 258 Iowa 409, 137 N.W.2d 605, 618 (1965) (exemplary damages awarded against shareholder-managing officer in two-man corporation for misappropriation).

for equity to exact of a defaulting corporate fiduciary not only the profits rightfully belonging to the corporation but an additional exaction for unconscionable conduct. There should be a deterrent to conduct which equity condemns and for which it grants relief.¹⁸²

Turner's action here was essentially one in equity, demanding that his fiduciary account for the funds and property which came into the fiduciary's hands while in sole charge of the liquidation process. On that basis, the court surely erred in denying recovery of exemplary damages.

Usury. In 1967, a new provision was added to the Texas Miscellaneous Corporation Laws Act as article 2.09 which permits a corporation borrowing funds to agree to pay up to one and one-half percent per month interest on any bond, note, debt, contract, or other obligation so long as the amount borrowed in a single loan or in a series of connected loans exceeds 5,000 dollars.¹⁸³ The article also specifically bars the assertion of usury as a claim or defense when the interest rate on moneys borrowed falls within the permitted limits. But whether the prohibition of the usury claim or defense under the circumstances set out in the statute applies retroactively to loans made before its passage was left unsettled.

An answer to that question has been provided in *Hockley County Seed & Delimiting, Inc. v. Southwestern Investment Co.*¹⁸⁴ In that case the Amarillo court of civil appeals determined the statute should not be given retroactive application,¹⁸⁵ following the general principle of statutory construction that unless a statute expressly and clearly states that it is to operate retroactively, it will be applied prospectively only.¹⁸⁶ As a consequence, the law in force at the time the note being sued on was executed would govern the usury issue even to the extent of permitting recovery of statutory penalties then prescribed for usurious transactions.¹⁸⁷

Administrative Dissolution. The TBCA contains detailed procedures for dissolution of corporations by voluntary action¹⁸⁸ or judicial proceeding.¹⁸⁹ But the Act also provides that corporate life can be terminated by administrative action of the secretary of state whenever a corporation has failed to file reports

¹⁸² 368 S.W.2d at 584.

¹⁸³ Ch. 296, § 1, [1967] Tex. Laws 713 (codified at TEX. REV. CIV. STAT. ANN. art. 1302-2.09 (Supp. 1972)). For a discussion of the new legislation, see Amsler, *supra* note 133, at 68; Comment, *Lender Participation in Borrower's Venture: A Scheme To Receive Usurious Interest*, 8 HOUSTON L. REV. 546, 567 (1971).

¹⁸⁴ 476 S.W.2d 38 (Tex. Civ. App.—Amarillo 1971), *error ref. n.r.e.*

¹⁸⁵ Cf. *Holland v. Gross*, 89 So. 2d 255 (Fla. 1956) (repeal of statute barring corporation from usury defense not applicable to loan made before repeal).

¹⁸⁶ See, e.g., *Government Personnel Mut. Life Ins. Co. v. Wear*, 151 Tex. 454, 461, 251 S.W.2d 525, 529 (1952); *National Carloading Corp. v. Phoenix-El Paso Express, Inc.*, 142 Tex. 141, 148, 176 S.W.2d 564, 568 (1943).

¹⁸⁷ The statutes then applicable penalized a usurious loan by forgiving the interest owed, ch. 6, § 1, [1892] Tex. Laws 5, 10 H. GAMMEL, LAWS OF TEXAS 369 (1898), and permitting recovery of double the usurious interest charged, ch. 163, § 1, [1907] Tex. Laws 277, 278. Both statutes were repealed, ch. 274, § 5, [1967] Tex. Laws 659, 660, and replaced by a new Consumer Credit Code, ch. 274, [1967] Tex. Laws 610-60. Similar penalties are found in the present law. TEX. REV. CIV. STAT. ANN. art. 5069-1.06 (1971).

¹⁸⁸ TEX. BUS. CORP. ACT ANN. arts. 6.01-.07 (1956).

¹⁸⁹ *Id.* arts. 7.01-.03, 7.06-.10.

in the time required by law or pay required fees, franchise taxes, or penalties when they become due or payable.¹⁹⁰ The secretary is given similar power under the Texas franchise tax law to forfeit the charter of any corporation if its right to do business has been forfeited by the comptroller of public accounts for nonpayment of franchise taxes and it has not revived that right within the time prescribed by law.¹⁹¹ Yet under both laws, the secretary of state, upon request, can revive a corporation through similar administrative action once all delinquent franchise tax reports have been filed and all franchise taxes, penalties, and interest due have been paid.¹⁹² Under the TBCA the application for reinstatement must be made within twelve months of dissolution, but no time period is prescribed for revival under the franchise tax law.¹⁹³

What is the corporation's status once administrative dissolution has occurred? If the corporation is reinstated under the TBCA procedures, then the answer is that "corporate existence shall be deemed to have continued without interruption from the date of dissolution except the reinstatement shall have no effect upon any issue of personal liability of the directors, officers, or agents of the corporation during the period between dissolution and reinstatement."¹⁹⁴ But, as just noted, revival under the TBCA must occur within twelve months. If more time than that has elapsed, any reinstatement must take place under the terms of the franchise tax law. While the latter also provides that there will be no effect on the liabilities incurred during the time the right to do business was first forfeited by the comptroller and the revival, it contains no language resembling that quoted from the TBCA concerning corporate existence.¹⁹⁵

Arguably, in the case of a corporation not revived until after the twelve-month period or one which never seeks reinstatement at all, the corporation should be given the limited degree of survival for three years provided by article 2.07 of the Miscellaneous Corporation Laws Act.¹⁹⁶ But a reading of that statute makes it doubtful the administratively-dissolved corporation comes within its purview. For one thing, it is limited to corporations dissolved (1) by issuance of a certificate of dissolution by the secretary of state, (2) by a decree of court when not all the assets or business of the corporation have been liquidated, and (3) by expiration of its period of duration. A certificate of dissolution is issued only on voluntary dissolution; when dissolution occurs by action of the secretary of state, he executes a certificate of involuntary dissolution,¹⁹⁷ or as provided in the franchise tax law, enters the words "Charter Forfeited" on the corporation's records in his office.¹⁹⁸ Second, article 2.07 specifically preserves the corporation's right to prosecute or defend in its name any action or proceeding by or against the corporation.¹⁹⁹ Yet under the

¹⁹⁰ *Id.* arts. 7.01(B)-(D).

¹⁹¹ TEX. REV. CIV. STAT. ANN. tit. 122A, art. 12.17(2) (1969).

¹⁹² *Id.* art. 12.17(3); TEX. BUS. CORP. ACT ANN. art. 7.01(E) (1956).

¹⁹³ See TEX. OP. ATT'Y GEN. No. M-600, at 2863, 2866 (1970).

¹⁹⁴ TEX. BUS. CORP. ACT ANN. art. 7.01(E) (1956).

¹⁹⁵ TEX. REV. CIV. STAT. ANN. tit. 122A, art. 12.17(3) (1969).

¹⁹⁶ *Id.* art. 1302-2.07 (1962).

¹⁹⁷ TEX. BUS. CORP. ACT ANN. art. 7.01(D) (1956).

¹⁹⁸ TEX. REV. CIV. STAT. ANN. tit. 122A, art. 12.17(2) (1969).

¹⁹⁹ *Id.* art. 1302-2.07(A) (1) (1962).

franchise tax law, a corporation whose right to do business has been forfeited for not paying the tax is denied the right to sue or defend in any court in the state, except in a forfeiture action brought by the state, nor, even in an action against it on a cause of action arising before forfeiture, can it be given any affirmative relief until the right to do business has been revived.²⁰⁰

During the survey period, two courts were confronted with the problem of deciding the nature of a corporation's existence after administrative forfeiture. In one case, the corporation had been revived; in the other, it had not.

In the first case²⁰¹ a minority shareholder brought an action against the president and principal shareholder of a corporation to partition and account for the corporation's assets on the theory that when the corporation's charter was forfeited under the franchise tax law by the secretary of state in 1966, its corporate existence ended and its assets vested in the shareholders pro rata with their stock ownership. Defendant responded that in 1971 the secretary had reinstated the corporation's charter under the same statute. He moved for summary judgment which was granted and then affirmed. It appeared that despite the forfeiture, the corporation had continued operating, paying its income taxes, and, interestingly enough, franchise taxes, except for the one year in which it must have inadvertently failed to file its return and upon which the forfeiture was based. It was not until the plaintiff filed suit that the defendant learned of his corporation's forfeiture and took steps to effectuate the revival. At the time of the summary judgment hearing, the secretary of state certified the corporation legally existed under the Texas law.

The court noted that from the time the franchise tax law was first enacted in 1907, to 1965 when the law was changed,²⁰² there was no procedure for reinstatement of corporations dissolved under the statute. The authorities relied on by the plaintiff dealt with corporations dissolved during that interim, and, therefore, did not apply.²⁰³ Because the purpose of the legislation is to raise revenue and provide an effective means for recovering delinquent taxes, and given the fact that no time period is prescribed for revival, the court held that a corporation is not extinguished as a legal entity after administrative dissolution, but simply loses the right to conduct business. Although the court did not explicitly hold that the corporation becomes de facto after forfeiture, it is evident from the opinion that the court considered its status to be precisely that.²⁰⁴ As a de facto corporation, it would then be free from collateral attack on the validity of its existence, except in a direct proceeding brought by the state.²⁰⁵

²⁰⁰ *Id.* tit. 122A, art. 12.14 (1969).

²⁰¹ *McGown v. Kittel*, 480 S.W.2d 47 (Tex. Civ. App.—Fort Worth 1972), *error ref. n.r.o.*

²⁰² Ch. 582, § 1, [1965] Tex. Laws 1268, *amended*, ch. 801, § 13, [1969] Tex. Laws 2366.

²⁰³ *Humble Oil & Ref. Co. v. Blankenburg*, 149 Tex. 498, 235 S.W.2d 891 (1951); *Gano v. Filter-Aid Co.*, 414 S.W.2d 480 (Tex. Civ. App.—Austin 1967), *discussed in Amsler*, *supra* note 133, at 77.

²⁰⁴ The court states that from the time of the administrative dissolution until reinstatement, the corporation "continued to operate as a de facto corporation." 480 S.W.2d at 49. Later it notes that in states which have a statutory reinstatement procedure, the corporation is regarded as de facto during the period of forfeiture. *Id.* at 50.

²⁰⁵ *See, e.g., Walling v. North Tex. Cent. Mun. Water Authority*, 162 Tex. 527, 529,

The court's implied holding that the corporation occupies a de facto status until reinstatement accords with the better view,²⁰⁶ although there is some authority it does not.²⁰⁷ Traditionally, the de facto doctrine has been used to deal with the consequences of defective incorporation,²⁰⁸ and statutes such as TBCA article 3.04,²⁰⁹ which make issuance of the certificate of incorporation conclusive evidence that all conditions precedent to incorporation have been met (except in a direct attack by the state) and which are thought to codify the de facto rule,²¹⁰ are sometimes held inapplicable in determining a corporation's post-dissolution standing.²¹¹ Yet, logically, there is no reason why a corporation which continues its operations should not be so regarded, and on that basis the court's opinion is sound.

The view that an administratively dissolved corporation becomes a de facto body would have been of some comfort to the court in the second survey case which considered the matter.²¹² In that case the court was genuinely concerned when asked to review a judgment won by a corporation some five months after being dissolved by the secretary of state for franchise tax delinquency and for not renewing its right to do business after that right was forfeited by the comptroller almost a year earlier. The court sustained the judgment because a verified denial of its existence had not been pleaded, as required by rules 52 and 93(g).²¹³ The validity of the plaintiff's corporate status and its capacity to sue could not be questioned in the absence of such a plea. Nevertheless, the court seemed bothered that it had a "judgment rendered in favor of a purported plaintiff that did not exist,"²¹⁴ and speculated whether execution could be issued in the corporation's name or if the defendant could prevail in a bill of review to set aside the judgment. It acknowledged that even if the corporation's non-existence had been shown, it would not necessarily follow that the judgment in its name was either void or erroneous.²¹⁵ But considering that time still remained for reinstatement under the TBCA, which provides that upon reinstatement corporate existence is deemed to have been uninter-

348 S.W.2d 532, 533 (1961) (dictum); *Miller v. Davis*, 136 Tex. 299, 307, 150 S.W.2d 973, 978 (1941) (dictum); *Mulcahy v. Houston Steel Drum Co.*, 402 S.W.2d 817, 820 (Tex. Civ. App.—Austin 1966), noted in *Pelletier*, *supra* note 4, at 153; *Commercial Standard Ins. Co. v. Nelson Mortgage Co.*, 138 S.W.2d 169, 173 (Tex. Civ. App.—Eastland 1940), error dismissed, judgment correct. See also 1 I. HILDEBRAND, *supra* note 41, at 408.

²⁰⁶ H. BALLANTINE, *supra* note 49, at 98 n.14; see W. CARY, *supra* note 48, at 83; H. HENN, *supra* note 12, at 248 n.11; Comment, *Suspension of Corporate Charter for Non-payment of Franchise Tax*, 48 YALE L.J. 650, 656 (1939). See generally Annot., 13 A.L.R.2d 1220 (1950) (reinstatement of repealed, forfeited, expired, or suspended corporate charter as validating acts in interim); Annot., 47 A.L.R. 1288, 1394-96 (1927), 97 A.L.R. 477, 485-86 (1935) (powers of corporation after expiration or forfeiture of its charter).

²⁰⁷ See H. HENN, *supra* note 12, at 248 n.12; Comment, *supra* note 206. See also 1 I. HILDEBRAND, *supra* note 41, § 175, for arguments against finding de facto existence.

²⁰⁸ See 1 G. HORNSTEIN, *supra* note 45, at § 27; N. LATTIN, *supra* note 6, at 183.

²⁰⁹ TEX. BUS. CORP. ACT ANN. art. 3.04 (1956).

²¹⁰ See Bar Committee Comment, 3A TEX. REV. CIV. STAT. ANN. 189, 190 (1956).

²¹¹ See, e.g., *Bland v. Knox Concrete Prods., Inc.*, 207 Tenn. 206, 338 S.W.2d 605 (1960).

²¹² *Wright v. Ewens Chevrolet-Pontiac-Buick Co.*, 481 S.W.2d 447 (Tex. Civ. App.—Houston [14th Dist.] 1972), error ref. n.r.e.

²¹³ TEX. R. CIV. P. 52, 93(g).

²¹⁴ 481 S.W.2d at 449.

²¹⁵ See, e.g., *Texas Mach. & Equip. Co. v. Gordon Knox Oil & Exploration Co.*, 442 S.W.2d 315 (Tex. 1969), noted in *Hamilton*, *supra* note 4, at 114.

rupted,²¹⁶ and that the de facto determination could have been employed, the court's preoccupation with the corporation's "non-existence" seems overly conceptualistic.

VI. PROCEDURAL MATTERS

Given the volume of litigation instituted by or against corporations each year, it is not surprising to find decisions that consider or turn on the procedural aspects of the corporation as a party to the action.

Jurisdiction. Two decisions illustrate the sweep of article 2031b,²¹⁷ the Texas long-arm statute. In *Custom Textiles, Inc. v. Crown Sample Book Co.*²¹⁸ the only physical contact with Texas was a visit by a Pennsylvania corporation's president prior to negotiating a contract for the manufacture of fabric sample books for a Texas corporation. When the Texas corporation sued for breach of contract, service on the Pennsylvania corporation under article 2031b was upheld on the basis that the president's visit, telephone conversation after he returned home, delivery of some of the sample books ordered in Texas, and payments made by the plaintiff from Texas to the defendant constituted sufficient minimum contact, ties, and relations with Texas to satisfy the constitutional standard.²¹⁹

In the other case, *National Truckers Service, Inc. v. Aero Systems, Inc.*,²²⁰ jurisdiction was upheld under article 2031b against a Florida corporation which mailed a guaranty contract to a Texas plaintiff which accepted it in Texas. The contract also specifically provided that it was to be performable in Texas. Given the breadth of the "doing business" definition in article 2031b,²²¹ which the courts have repeatedly said was intended "to exploit to the maxi-

²¹⁶ TEX. BUS. CORP. ACT ANN. art. 7.01(E) (Supp. 1972).

²¹⁷ TEX. REV. CIV. STAT. ANN. art. 2031b (1964).

²¹⁸ 472 S.W.2d 848 (Tex. Civ. App.—Waco 1971), *error ref. n.r.e.*

²¹⁹ In *International Shoe Co. v. Washington*, 326 U.S. 310, 316 (1945), the court held that due process is satisfied, assuming adequate notification, if the defendant has "certain minimum contacts with [the forum] such that the maintenance of the suit does not offend traditional notions of fair play and substantial justice." In *McGee v. International Life Ins. Co.*, 335 U.S. 220 (1957), jurisdiction over a foreign insurer whose sole contact with the forum state was mailing a reinsurance certificate to a local resident and accepting premiums on the policy the insured sent by mail was upheld. In *Hanson v. Denckla*, 357 U.S. 235 (1958), the Court partially retreated from the *McGee* position by refusing to sustain a Florida court's jurisdiction over a Delaware trust company whose sole contact with Florida had been in remitting trust income to a beneficiary residing there and answering correspondence from her. It ruled that "it is essential in each case that there be some act by which the defendant purposely avails itself of the privilege of conducting activities within the forum State, thus invoking the benefit and protection of its laws." *Id.* at 253. Although there is some disagreement on how much retrenchment the *Hanson* case represents, it does serve to "underscore the continuing importance of nexus with a state sufficient to make it reasonable for that state to exercise in personam jurisdiction over an absent defendant." R. WEINTRAUB, *supra* note 30, at 92. See generally A. EHRENZWEIG, *supra* note 30, § 33; H. HENN, *supra* note 12, § 97; F. JAMES, *supra* note 20, § 12.8; G. STUMBERG, *supra* note 30, at 93.

²²⁰ 480 S.W.2d 455 (Tex. Civ. App.—Fort Worth 1972), *error ref. n.r.e.*

²²¹ "For the purpose of this Act, and without including other acts that may constitute doing business, any foreign corporation . . . shall be deemed doing business in this State by entering into contract by mail or otherwise with a resident of Texas to be performed in whole or in part by either party in this State, or the committing of any tort in whole or in part in this State." TEX. REV. CIV. STAT. ANN. art. 2031b, § 4 (1964).

mum the fullest permissible reach under federal constitutional restraints,"²²² it is hard to quarrel with either case.

The *National Truckers* case also raised a novel question of interpretation of article 2031b, *i.e.*, whether a foreign corporation licensed to do business in the state can be deemed a resident of Texas to gain the benefit of the statute. The operative language of section 4 of article 2031b is in terms of a non-resident entering into a contract by mail or otherwise "*with a resident of Texas*" performable in whole or in part in the state. The plaintiff was a Maryland corporation but had a certificate of authority to do business in Texas where it maintained its principal office and place of business. The defendant argued that as a Maryland corporation, the plaintiff could not be a Texas resident. Acknowledging the matter had not been previously decided under 2031b, the court held the plaintiff would be considered a resident. It relied largely on cases which held that a corporation's residence for purposes of venue is where it maintains its principal place of business²²³ and on TBCA article 8.02 which gives admitted foreign corporations the same rights and privileges as domestic corporations.²²⁴ It further opined that to deny a qualified corporation access to the courts in initiating a suit but permitting it to be sued would be a denial of equal protection of the laws.²²⁵ Although the court did not con-

²²² *Lone Star Motor Import, Inc. v. Citroen Cars Corp.*, 288 F.2d 69, 73 (5th Cir. 1961) (Brown, J.); *accord, e.g.*, *Gurley v. Lindsley*, 459 F.2d 268, 278 (5th Cir. 1972); *Eyerly Aircraft Co. v. Killian*, 414 F.2d 591, 598-99 (5th Cir. 1969); *Atwood Hatcheries v. Heisdorf & Nelson Farms*, 357 F.2d 847, 852 (5th Cir. 1966).

Interestingly enough, expressions in Texas decisions do not go this far. The criteria most often repeated are those expressed by the Texas Supreme Court in *O'Brien v. Lanpar Co.*, 399 S.W.2d 340, 342 (Tex. 1966), which the court in turn derived from *Tyee Constr. Co. v. Dulien Steel Prods., Inc.*, 62 Wash. 2d 106, 381 P.2d 245, 251 (1963). These are: "(1) The nonresident defendant or foreign corporation must purposefully do some act or consummate some transaction in the forum state; (2) the cause of action must arise from, or be connected with, such act or transaction; and (3) the assumption of jurisdiction by the forum state must not offend traditional notions of fair play and substantial justice, consideration being given to the quality, nature, and extent of the activity in the forum state, the relative convenience of the parties, the benefits and protection of the laws of the forum state afforded the respective parties, and the basic equities of the situation." 399 S.W.2d at 342; *accord, Sun-X Int'l Co. v. Witt*, 413 S.W.2d 761, 765 (Tex. Civ. App.—Texarkana 1967), *error ref. n.r.e.*; *Trinity Steel Co. v. Modern Gas Sales & Serv. Co.*, 392 S.W.2d 861 (Tex. Civ. App.—Texarkana 1965), *error ref. n.r.e.* See generally 2 R. McDONALD, *TEXAS CIVIL PRACTICE* §§ 9.29.5, 9.29.6 (rev. repl. 1970); Thode, *In Personam Jurisdiction; Article 2031b, the Texas "Long Arm" Jurisdiction Statute; and the Appearance To Challenge Jurisdiction in Texas and Elsewhere*, 42 TEXAS L. REV. 279, 297-310 (1964); Comment, *Jurisdiction Over Foreign Corporations Under Article 2031b*, 39 TEXAS L. REV. 214 (1960). See also notes 28-39 *supra*, and accompanying text.

²²³ *Wirt Franklin Petroleum Corp. v. Gruen*, 139 F.2d 659, 660 (5th Cir. 1944) (garnishment); *Pittsburg Water Heater Co. v. Sullivan*, 115 Tex. 417, 423, 282 S.W. 576, 579 (Tex. Comm'n App. 1926), *opinion adopted* (venue); *Mergenthaler Linotype Co. v. Hermann*, 211 S.W.2d 633, 634-35 (Tex. Civ. App.—Fort Worth 1948) (venue); *Jaques Power Saw Co. v. Womble*, 207 S.W.2d 206, 208 (Tex. Civ. App.—Waco 1947) (venue); *Merchant's Fast Motor Lines, Inc. v. Levens*, 161 S.W.2d 853, 854 (Tex. Civ. App.—Amarillo 1942) (venue); *Sanders v. Farmers State Bank*, 228 S.W. 635, 636 (Tex. Civ. App.—Dallas 1921) (garnishment).

²²⁴ A qualified foreign corporation "shall . . . enjoy the same, but no greater, rights and privileges as a domestic corporation organized for the purposes set forth in the application pursuant to which such certificate of authority is issued . . ." TEX. BUS. CORP. ACT ANN. art. 8.02 (1956).

²²⁵ 480 S.W.2d at 458, citing *C.H. Leavell & Co. v. Doster*, 211 So. 2d 813 (Miss. 1968). *But see* *Commercial Ins. Co. v. Adams*, 369 S.W.2d 927 (Tex. 1963) (refusing to grant error and approving holding in 366 S.W.2d 801, 809 (Tex. Civ. App.—Houston 1963)), in which the constitutionality of subdivision 27 of TEX. REV. CIV. STAT. ANN. art. 1995 (1964) was upheld. The court held that the statute did not deny equal protection

sider the effect of the supreme court's decision in *Ward v. Fairway Operating Co.*,²²⁶ in which it was held that the county in which the registered office is located is a corporation's primary residence for general venue purposes, *Ward* also made it clear the corporation's principal office or place of business could also be used to fix venue. Arguably, the same dual residence rule applies to qualified foreign corporations.²²⁷ Certainly there is no logical reason why a domesticated corporation should not be considered a resident of the state in which it carries on its principal activities.²²⁸

Tolling Statute of Limitation. In a somewhat related case dealing with foreign corporations, *Mehaffey v. Barrett Mobile Home Transport, Inc.*,²²⁹ the question presented was whether a foreign corporation was "present" within the state when the cause of action against it began to accrue so as to suspend limitation under article 5537.²³⁰ Under that statute, if a person is absent from the state at the time the action against him accrues or while it might be maintained, the limitation period is tolled until his return. Although the law is similar to suspension statutes in other jurisdictions, Texas seemingly stands alone in interpreting its statute to exclude nonresidents who have never been in the state from its application.²³¹ The construction is based on a literal reading of the word "return" in the statute, since it stands to reason that one never in the state cannot "return" to it so as to commence the limitation period again.²³² The gloss is derived from an early reading of the law which was passed in 1841²³³ to discourage immigrants into the Republic from emigrating

of the laws to a foreign corporation, although it afforded a wider venue against a foreign corporation than a domestic one under subdivision 23 of the same article. The per curiam decision expressly overruled two cases that had held subdivision 27 unconstitutional on equal protection grounds, *Maryland Cas. Co. v. Torrez*, 359 S.W.2d 559 (Tex. Civ. App.—Eastland), *error dismissed w.o.j.*, 363 S.W.2d 235 (Tex. 1962); and *Fireman's Fund Ins. Co. v. McDaniel*, 327 S.W.2d 358 (Tex. Civ. App.—Beaumont 1959). See Note, *The Constitutional Problem of Providing Venue Classification for Foreign Corporations in Texas*, 18 Sw. L.J. 291, 299-300 (1964).

²²⁶ 364 S.W.2d 194 (Tex. 1963), *rev'g* 358 S.W.2d 143 (Tex. Civ. App.—Waco 1962).

²²⁷ No case decided since *Ward* has so held, although in *O.M. Franklin Serum Co. v. C.A. Hoover & Son*, 410 S.W.2d 272, 273 (Tex. Civ. App.—Amarillo 1966), *error ref. n.r.e.*, the court indicated a qualified foreign corporation having a laboratory in Potter County and service agent in Travis County would be considered a resident of either county for venue purposes. Also, in *Pepsi-Cola Co. v. Spangler*, 401 S.W.2d 923, 925 (Tex. Civ. App.—Texarkana 1966), a foreign corporation was deemed a resident of Dallas county, where it maintained its office, for general venue purposes; to be amenable to suit elsewhere, venue would have to be sustained under the exceptions to art. 1995. See *J.I. Case Co. v. Darcy*, 424 S.W.2d 501 (Tex. Civ. App.—Amarillo 1968) (a foreign corporation with a permit to do business here is a resident for venue purposes). See also 1 R. McDONALD, *supra* note 222, § 4.03.3, at 420 (rev. repl. 1965); Note, *supra* note 225, at 301-02.

²²⁸ Cf. *Wirt Franklin Petroleum Corp. v. Gruen*, 139 F.2d 659, 660 (5th Cir. 1944) (foreign corporation conducting principal business activities and having centralized management in Texas makes Texas its domicile in fact; hence situs of stock for attachment or garnishment is in Texas). See generally A. EHRENZWEIG, *supra* note 30, § 145.

²²⁹ 473 S.W.2d 643 (Tex. Civ. App.—Fort Worth 1971).

²³⁰ TEX. REV. CIV. STAT. ANN. art. 5537 (1958).

²³¹ Annot., 17 A.L.R.2d 502, 506 (1951); see *Stone v. Phillips*, 142 Tex. 216, 176 S.W.2d 932 (1944); *Wilson v. Daggett*, 88 Tex. 375, 31 S.W. 618 (1895).

²³² *Wilson v. Daggett*, 88 Tex. 375, 376, 31 S.W. 618, 619 (1895); *Snoddy v. Cage*, 5 Tex. 106, 109 (1849).

²³³ Act of Feb. 5, 1841, § 22, [1841] Tex. Laws 170, 2 H. GAMMEL, LAWS OF TEXAS 634 (1898).

again.²³⁴ Despite its aberrance, the interpretation has been consistently adhered to by the Texas courts.²³⁵ As a consequence, Texas law is in the anomalous position of preferring a nonresident defendant who remains out of the state until limitation has expired over a resident defendant who subsequently leaves the state, even though the latter might remain amenable to personal jurisdiction in Texas.²³⁶

An exception to the interpretation has been recognized, however. If a nonresident defendant was present in the state at the time the action against him accrued, the suspension statute will apply to him if he subsequently leaves the state.²³⁷ In the case of a natural person, presence is usually proven by showing the defendant was physically within the state at the time the limitation commenced.²³⁸ But when the defendant is a foreign corporation not qualified to do business when the action accrued,²³⁹ determining its "presence" becomes a more difficult matter, as *Mehaffey* illustrates.

In *Mehaffey* the defendant was a Minnesota corporation which had agreed to transport the Texas plaintiff's mobile home from North Dakota to Texas. It was not qualified to do business in Texas and did not have any agents here; its only contact with the state was the single transaction when its truck driver delivered the mobile home to the plaintiff. Because the home was delivered

²³⁴ *Moore v. Hendrick*, 8 Tex. 253, 255 (1852); *Snoddy v. Cage*, 5 Tex. 106, 114 (1849); *Love v. Doak & Tims*, 5 Tex. 343, 347 (1849). The legislation was also designed to encourage immigration because of another provision of the 1841 statutes of limitation which barred recovery on any action against an immigrant which would be barred by limitation in the country or state from whence he emigrated. Act of Feb. 5, 1841, § 13, [1841] Tex. Laws 166, 2 H. GAMMEL, LAWS OF TEXAS 630 (1898). At the same time, the suspension statute was recognized as a benefit to domestic creditors to protect them against the inconvenience and loss to which they would be exposed by the absence of their debtors. *Gibson v. Nadel*, 164 F.2d 970 (5th Cir. 1947).

²³⁵ *E.g.*, *Alley v. Bessemer Gas Engine Co.*, 262 F. 94, 95 (5th Cir. 1919); *Wise v. Anderson*, 163 Tex. 608, 611, 359 S.W.2d 876, 879 (1962); *Stone v. Phillips*, 142 Tex. 216, 219, 176 S.W.2d 932, 933 (1944).

²³⁶ The leading case so holding is *Vaughn v. Deitz*, 430 S.W.2d 487 (Tex. 1968), noted in *McElhanev*, *Texas Civil Procedure, Annual Survey of Texas Law*, 23 Sw. L.J. 177, 180 (1969). The Texas Supreme Court applied the suspension statute to toll limitation against defendant motorists who were Texas residents at the time of the automobile collision with plaintiffs but subsequently left the state even though in personam jurisdiction over defendants could be (and was) exercised under the nonresident motorist statute, TEX. REV. CIV. STAT. ANN. art. 2039a (1964). It rejected an equal protection argument that with the enactment of art. 2039a a nonresident defendant is in the same position as a resident insofar as amenability to suit is concerned.

Most states regard their suspension statutes as inoperable when jurisdiction either in personam or in rem can be obtained. Annot., 17 A.L.R.2d 502, 516 (1951).

²³⁷ *Gibson v. Nadel*, 164 F.2d 970, 971 (5th Cir. 1947); *Graham v. Engleman*, 263 F. 166, 169 (S.D. Tex. 1920); *Wise v. Anderson*, 163 Tex. 608, 611, 359 S.W.2d 876, 879 (1962); *Stone v. Phillips*, 142 Tex. 216, 220, 176 S.W.2d 932, 934 (1944); *Mehaffey v. Barrett Mobile Home Transport, Inc.*, 473 S.W.2d 643, 646 (Tex. Civ. App.—Fort Worth 1971).

²³⁸ See *Graham v. Engleman*, 263 F. 166, 169 (S.D. Tex. 1920); *Stone v. Phillips*, 142 Tex. 216, 220, 176 S.W.2d 932, 934 (1944); *cf.* *Wise v. Anderson*, 163 Tex. 608, 613, 359 S.W.2d 876, 880 (1962), in which it was held that the burden of pleading and proving the defendant's subsequent absence is on the plaintiff when the limitation defense has been raised.

²³⁹ Presumably, a qualified foreign corporation having a registered agent, appointed pursuant to TEX. BUS. CORP. ACT ANN. art. 8.08 (1956), upon whom service of process can be served, would be deemed a resident or "present" within the meaning of the suspension statute. This is the general rule, based on the reasoning that such statutes are not intended to apply to any party who can be subjected to the state's judicial jurisdiction at any time. 18 W. FLETCHER, *supra* note 37, at 188. No Texas cases have so held, although there is authority which suggests the same result. See note 251 *infra*.

in badly damaged condition, the plaintiff sued both for breach of the delivery contract and for negligence. His petition showed on its face it was barred by limitation, and despite his contention that article 5537 suspended limitation, summary judgment was granted against him. That judgment was affirmed by the Fort Worth court of civil appeals.

In reaching its decision, the Fort Worth court decided it would have to determine whether Texas courts would have had jurisdiction over the defendant during the time the truck driver was in the state delivering the home and whether at that time it had an agent within Texas competent to accept process. It concluded that the defendant was not subject to the jurisdiction of Texas courts, nor could it have been served in Texas. The isolated nature of the transaction brought it within subsections (9) and (10) of TBCA article 8.01(B) which provided that transactions in interstate commerce or of an isolated nature completed within thirty days "shall not be considered to be transacting business *for the purposes of this Act.*"²⁴⁰ If it were not doing business, it could not have been "present" within the meaning of the suspension statute. Second, under article 2031,²⁴¹ the only service statute the court thought applicable,²⁴² the truck driver did not fall within any of the categories of authorized agents specified in that statute as competent to receive service of process for a foreign corporation. Moreover, the court stated that the truck driver was a servant and not an agent.²⁴³

The court's conclusion was probably correct in light of the policy, albeit archaic, which underlies the suspension statute and its subsequent interpretation. Its reliance on older jurisdictional and agency criteria to determine a foreign corporation's "presence" within the state at the time the action against it accrues seems misplaced, however. These tests may have sufficed when the

²⁴⁰ TEX. BUS. CORP. ACT ANN. arts. 8.01(B)(9), (10) (1956) (emphasis added).

²⁴¹ TEX. REV. CIV. STAT. ANN. art. 2031 (1964). The statute authorizes service of process on a foreign corporation or joint stock company by service on its president, vice president, secretary, treasurer, general manager, or any local or traveling agent or traveling salesman.

²⁴² TEX. REV. CIV. STAT. ANN. arts. 2031b (the long-arm statute) and 2039a (non-resident motorist statute) (1964) were deemed not relevant in answering the second test, although it is difficult to see why the secretary of state as the constructive service agent of a defendant who has been doing sufficient business in Texas to fall within the broad scope of the definition of that term in art. 2031b does not come within the formulation. See notes 221, 222 *supra*, and accompanying text. Likewise, TEX. REV. CIV. STAT. ANN. art. 2031a (1964) and TEX. BUS. CORP. ACT ANN. art. 8.10 (1956) were deemed inapplicable since, by their own terms, they apply only to foreign corporations doing business in Texas. In a sense, the court begs the question, because the critical inquiry should be whether the truck driver's acts within Texas sufficed to constitute doing business under those statutes. See note 251 *infra*.

²⁴³ According to the *Restatement of Agency* a servant is an agent. He is distinguished from a non-servant in that his physical conduct in the performance of his duties is controlled by or subject to the control of his master. RESTATEMENT (SECOND) OF AGENCY § 8 (1958); see W. SEAVEY, HANDBOOK OF LAW OF AGENCY 8 (1964). Several recent Texas cases follow the same classification. See *Graham v. McCord*, 384 S.W.2d 897 (Tex. Civ. App.—San Antonio 1964); *Nagelson v. Fair Park Nat'l Bank*, 351 S.W.2d 925 (Tex. Civ. App.—Dallas 1961), *error ref. n.r.e.* Other courts, however, continue to confine the term, as the court here seems to, to one able to represent and bind his principal contractually. *Humble Oil & Ref. Co. v. Bell*, 172 S.W.2d 800 (Tex. Civ. App.—El Paso 1943); *Talley v. Shasta Oil Co.*, 146 S.W.2d 802 (Tex. Civ. App.—Texarkana 1940); *Gulf Ref. Co. v. Shirley*, 99 S.W.2d 613 (Tex. Civ. App.—Eastland 1936), *error dismissed*; see P. MECHEM, OUTLINES OF THE LAW OF AGENCY 4-5 (4th ed. 1952). It is likely the reference to a traveling agent in art. 2031 was made with the latter concept in mind; in that sense, the court's construction is correct.

"doing business" standard served to limit judicial jurisdiction, but they no longer square with the more recent view of personal jurisdiction over foreign corporations and other non-residents,²⁴⁴ which the court seemed to overlook. In light of the broadened definition of doing business in article 2031b to include breach of contract in whole or in part in this state, there seems little doubt Texas courts could have asserted jurisdiction over the defendant corporation because of the delivery of the home in Texas.²⁴⁵ The fact the transaction was an isolated one or arose in interstate commerce and thus comes under the TBCA's statement of what does not constitute doing business here is beside the point; the TBCA includes these transactions among those which do not necessitate *qualification* as a foreign corporation, but that enumeration should have no bearing on the issue of jurisdiction.²⁴⁶

True, the truck driver would not have been a proper agent for service of process under article 2031, but that statute no longer applies to corporations governed by the TBCA²⁴⁷ and would seem to be eclipsed by the broader scope

²⁴⁴ See notes 219, 221 *supra*, and accompanying text.

²⁴⁵ See *Clark Advertising Agency, Inc. v. Tice*, 331 F. Supp. 1058 (N.D. Tex. 1971); *Jetco Electronic Indus. v. Gardiner*, 325 F. Supp. 80 (S.D. Tex. 1971); *Mitsubishi Shoji Kaisha, Ltd. v. M.S. Galini*, 323 F. Supp. 79 (S.D. Tex. 1971); *Standard Leasing Co. v. Performance Systems, Inc.*, 321 F. Supp. 977 (N.D. Tex. 1971); *Barnes v. Irving Trust Co.*, 290 F. Supp. 116 (S.D. Tex. 1968); *Uvalde Rock Asphalt Co. v. Consolidated Carpet Corp.*, 457 S.W.2d 649 (Tex. Civ. App.—Beaumont 1970), *error ref. n.r.e.*; *cf. Castle v. Berg*, 415 S.W.2d 523 (Tex. Civ. App.—Dallas 1967). *But cf. Sun-X Int'l Co. v. Witt*, 413 S.W.2d 761 (Tex. Civ. App.—Texarkana 1967), *error ref. n.r.e.* See also *Beck v. Spindler*, 256 Minn. 543, 99 N.W.2d 670 (1959) (jurisdiction upheld in action for breach of express warranty against nonresident house trailer manufacturer who shipped trailer to dealer in Minnesota who sold it to the plaintiff there). For a case with a fact situation almost opposite to the instant decision, see *Trinity Steel Co. v. Modern Gas Sales & Serv. Co.*, 392 S.W.2d 861 (Tex. Civ. App.—Texarkana 1965), *error ref. n.r.e.* (no jurisdiction under art. 2031b over New Jersey purchaser of truck which was delivered from Texas manufacturer to purchaser in New Jersey by an independent contractor).

²⁴⁶ The various activities listed in TEX. BUS. CORP. ACT ANN. art. 8.01(B) (1956) as not constituting business are derived from § 106 of the Model Business Corporation Act and were formulated to clarify when qualification would not be required, in view of the confusion caused by courts deciding qualification issues on the basis of standards which had been formulated to determine whether a foreign corporation could be subjected to local taxation or judicial jurisdiction. 2 ABA, MODEL BUS. CORP. ACT ANN. § 106, comment at 622 (2d ed. 1971). The criteria for determining the need for qualification are generally more severe than those permitting local taxation or amenability to process; they are hardly uniform, as the court seems to assume. See, e.g., *Eli Lilly & Co. v. Sav-On-Drugs, Inc.*, 366 U.S. 276, 288 (1971) (dissenting opinion); *O'Brien v. Lanpar Co.*, 399 S.W.2d 340, 343 (Tex. 1966). See generally RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 311, comment f at 338 (1971); H. HENN, *supra* note 12, at 148; 2 G. HORNSTEIN, *supra* note 45, § 581.

²⁴⁷ *Investors Diversified Serv., Inc. v. Bruner*, 366 S.W.2d 810 (Tex. Civ. App.—Houston 1963), *error ref. n.r.e.*; 2 R. McDONALD, *supra* note 222, at 416; Garwood, *Outline Brief: Some Effects of Foreign Corporations Qualifying or Failing To Qualify To Do Business in Texas*, 26 TEX. B.J. 845, 848 (1963); Shepherd, *Foreign Corporations Doing Business in Texas*, in 3A TEX. REV. CIV. STAT. ANN. 473, 488 (1956). There is also some indication a foreign corporation which could have obtained a certificate of authority under the TBCA but did not is subject to the sanctions against bringing suit spelled out in TEX. BUS. CORP. ACT ANN. art. 8.18 (1956), rather than the more onerous penalties prescribed in TEX. REV. CIV. STAT. ANN. art. 2031a (1964). *State v. Cook United, Inc.*, 464 S.W.2d 105, 107 (Tex. Civ. App.—Fort Worth), *modified on other grounds*, 469 S.W.2d 709 (Tex. 1971). On the other hand, it has been held that TEX. REV. CIV. STAT. ANN. arts. 2031, 2031a (1964) apply to foreign insurance companies, since under TEX. BUS. CORP. ACT ANN. art. 9.14 (1956) the Act does not govern insurance companies. *Bankers Life & Cas. Co. v. Watson*, 436 S.W.2d 404 (Tex. Civ. App.—Tyler 1968), *error ref. n.r.e.* But a careful reading of art. 9.14(A), TEX. INS. CODE ANN. art. 2.18 (1963), and Texas Miscellaneous Corporation Laws Act art. 1.03, TEX. REV. CIV. STAT. ANN. art. 1302-1.03 (1962), suggests the TBCA could readily apply.

of article 2031b.²⁴⁸ The statute suspending the limitation period is premised on the fear that if the resident (or nonresident if present when the cause of action accrued) leaves that state, he may escape its jurisdiction.²⁴⁹ But if the state can gain jurisdiction through its long-arm statute by constructive service, if necessary, the fact that the employee whose completed act within the state enables the state to assert its judicial power over his employer is himself not competent to receive service of process seems immaterial.

Nevertheless, reliance on the older standards for determining the presence of a foreign corporation for purposes of the suspension statute makes some sense so long as that law continues to be interpreted to exclude never-present nonresidents from its scope. Physical presence in Texas at the time of the consummated wrong is required of the defendant who is a natural person, and if he was not present then, the statute will not be tolled against him even if he later makes an occasional visit to the state.²⁵⁰ There is no reason why something equivalent to physical presence, *i.e.*, some substantial and continuing contact with the state, cannot be used as a standard to determine whether a foreign corporation was sufficiently "present" to justify being brought under the suspensory provision.²⁵¹ Since there appears to be no constitutional over-

²⁴⁸ Article 2031b, § 2, permits service of process on the person in charge of the business in which the foreign corporation is engaged in Texas, and allows substituted service on the secretary of state under §§ 1, 3, and 5. These procedures make more sense than sanctioning service on the various representatives specified in art. 2031. But because arts. 2031 and 2031a were not repealed when either the long-arm statute or the TBCA was adopted, and in view of the provision in § 7 of the former that it is cumulative of existing statutes, both statutes remain on the books as a source of confusion both to Texas and non-Texas lawyers. Neither is needed now that art. 2031b, which was drafted in light of the Supreme Court's decisions and has been construed to be as broad as the constitutional standards of minimum contact and due process will allow (*see notes 219, 221 supra*) is available. *See Thode, supra note 222, at 307-08*; Thode, "Long Arm" Jurisdiction and Special Appearance—A Reply, 28 TEX. B.J. 271, 272 (1965); Wilson, *Jurisdiction Over Non-Residents*, 22 TEX. B.J. 221, 222 (1959); Wilson, *In Personam Jurisdiction Over Non-Residents*, 9 BAYLOR L. REV. 363, 376 (1957) (proposing a nonresident service statute; art. 2031b is in substantially the same form and language as proposed by Professor Wilson). The Committee on Revision of Corporation Laws of the State Bar of Texas Section on Corporation, Banking and Business Law has proposed repeal of arts. 2031, 2031-1, and 2031a "because of overlapping and sometimes conflicting standards dealing with service of process on foreign corporations and other business associations and the fact the TBCA, the Texas Non-Profit Corporation Act and Article 2031b of Vernon's Civil Statutes make adequate provision for such service of process." Kerr, *Proposed Amendments to Corporation Laws*, 35 TEX. B.J. 1133, 1134 (1972). The proposal has been introduced in the current session of the legislature. S.B. 115, 63d Legis. §§ 1, 2 (1973).

²⁴⁹ *E.g.*, *Banana Distrib., Inc. v. United Fruit Co.*, 269 F.2d 790 (2d Cir. 1969); *Benally v. Pigman*, 78 N.M. 189, 429 P.2d 648 (1967); *Summerrise v. Stephens*, 74 Wash. 2d 808, 454 P.2d 224 (1969); *Thompson v. Texas Land & Cattle Co.*, 24 S.W. 856 (Tex. Civ. App. 1893); *see 18 W. FLETCHER, supra note 37, at 192*; 51 AM. JUR. 2D *Limitation of Action* 731 (1970); Note, *Limitation of Actions*, 1 ST. MARY'S L.J. 118, 119 (1969).

²⁵⁰ *Wilson v. Daggert*, 88 Tex. 375, 377, 31 S.W. 618, 619 (1895); *Watts v. McCloud*, 205 S.W. 381, 382 (Tex. Civ. App.—Amarillo 1918), *error ref.*; *Greer v. Gill*, 35 S.W. 328, 330 (Tex. Civ. App. 1896).

²⁵¹ This is in essence the criterion earlier cases, relied on in *Mebaffey*, seem to have established for foreign corporations. *See Alley v. Bessemer Gas Engine Co.*, 262 F. 94 (5th Cir. 1919); *Chambliss v. Simmons*, 165 F.2d 419 (5th Cir. 1908); *Thompson v. Texas Land & Cattle Co.*, 24 S.W. 856 (Tex. Civ. App. 1893); *cf. Harris v. Columbia Broadcasting System, Inc.*, 405 S.W.2d 613 (Tex. Civ. App.—Austin 1966), *error ref. n.r.e.* Although those cases regard the availability of an agent upon whom service could be had as a decisive factor, it is evident from their facts that the courts were more concerned with establishing a standard which would measure the quantum of activity needed to invoke the suspension statute insofar as a foreign corporation was concerned, rather than hold the statute inapplicable because the consequent amenability of the foreign corporation to suit cured the

tones to the matter, defining presence in terms of doing the quantum of business that would require qualification under the TBCA provides a more easily ascertainable and certainly more logical standard than the jurisdictional criteria the Texas courts have previously used.²⁵³ There would also be the added advantage of utilizing the statutory enumeration of acts that do not constitute the doing of business spelled out in article 8.01, even though in *Mehaffey* the court confused them with jurisdictional norms. There was nothing wrong with the standards the court used; its error was clinging to them as jurisdictional antecedents without being aware of their expansion beyond the purview of the suspension statute.

Venue. As noted earlier,²⁵³ the residence of a domestic corporation under the basic venue rule in Texas is the county in which its registered office is located, whether it conducts its principal business activities there or not. The post office address of the registered office must be stated in the articles of incorporation,²⁵⁴ although it may be changed later by a proper filing with the secretary of state.²⁵⁵ Thus, corporate residence is fixed for general venue purposes wherever the registered office is stated to be, and not, as a plaintiff unsuccessfully claimed in one of the survey cases,²⁵⁶ by an assumed name certificate showing the corporation was transacting business under another name in a different county.²⁵⁷ Nevertheless, under one of the exceptions to the general venue rule, venue can also be laid against a domestic corporation in the county in which its principal office is situated, if the corporation chooses to designate its registered office in another county.²⁵⁸ On that basis, the assumed name

ill for which such legislation was passed. See 23 Sw. L.J. 410, 413 (1969); Note, *supra* note 249. Given the narrower view of the extent to which judicial jurisdiction could be exercised at the time these cases were decided, it is not surprising the same "doing business" test was used. Moreover, in both *Alley* and *Thompson* the court went on to consider whether there had been a subsequent withdrawal of the foreign corporation, whose presence they decided had been established by representatives upon whom process could be served, in order to determine if limitation had been tolled under the statute.

²⁵² Cf. *Banana Distrib. Inc. v. United Fruit Co.*, 269 F.2d 790 (2d Cir. 1959).

²⁵³ See text accompanying note 226 *supra*.

²⁵⁴ TEX. BUS. CORP. ACT ANN. art. 3.02(A)(10) (Supp. 1972).

²⁵⁵ *Id.* art. 2.10.

²⁵⁶ *Texas Auto Serv., Inc. v. Kemp*, 478 S.W.2d 646 (Tex. Civ. App.—Austin 1972).

²⁵⁷ Any person conducting or transacting business under an assumed name is required to file a certificate in the office of the county clerk where the business is to be carried on, setting out the assumed name and revealing the true name or names of the person or persons involved. TEX. REV. CIV. STAT. ANN. art. 5924 (1962). Although domestic and foreign corporations lawfully doing business in the state are expressly exempted from the filing requirement, *id.* art. 5927, the TBCA states that a domestic or qualified foreign corporation may conduct business under an assumed name by filing the prescribed assumed name certificate. TEX. BUS. CORP. ACT ANN. art. 2.05(B) (1956). Since the assumed name statutes were enacted in 1921, the TBCA provision, as the latest expression of the legislative will, should govern.

²⁵⁸ "Suits against a private corporation . . . may be brought in the county in which its principal office is located . . ." TEX. REV. CIV. STAT. ANN. art. 1995, subd. 23 (1964). See *Ward v. Fairway Operating Co.*, 364 S.W.2d 194 (Tex. 1963), discussed in notes 226-29 *supra*, and accompanying text. See generally 1 R. McDONALD, *supra* note 222, § 4.30.1 (rev. repl. 1965).

The court in the instant case states that under subdivision 23 the venue facts to be proved are: (1) plaintiff has a cause of action; (2) he resides in the county when his claim or a part thereof arose, and (3) the corporation has an agent or representative in the county. 478 S.W.2d at 647-48. Despite its inclusive statement, it is evident the court was responding to another of the venue exceptions provided for in subdivision 23 and relied upon by the plaintiffs to maintain venue in the county in which the action was brought. Al-

certificate should be relevant evidence to prove the location of the principal office as a venue fact.

A somewhat unusual mode of proving that a corporate defendant was a foreign corporation was used in another venue case,²⁵⁹ in which the plaintiff relied on the foreign corporation venue provisions.²⁶⁰ A bank trust officer was permitted to testify that as an investment analyst he was familiar with the operation, place of incorporation, and location of major American companies and that on the basis of his studies and literature directly received from the defendant he knew it was a New York corporation. The court rejected the defendant's assertion that the evidence was hearsay, saying it was firsthand knowledge based on the officer's "direct personal dealings with the company."²⁶¹

Service of Process. Whenever the registered agent of a domestic corporation cannot be found after diligent search at the registered office or the corporation fails to appoint or maintain a registered agent, article 2.11(B) of the TBCA designates the secretary of state as the corporation's agent for service of process.²⁶² But the procedures spelled out in the article must be strictly followed to be certain the constructive service is effective. Two of the survey cases illustrate the need for strict compliance. In *Ratcliff v. Werlein*,²⁶³ for example, service of a writ of garnishment on the secretary of state as service agent for a corporation which failed to maintain a registered agent was held insufficient because the record showed that only one copy of the writ had been served instead of duplicate copies as required by the statute.

When, as in the second case,²⁶⁴ a default judgment is obtained and later directly attacked, the courts are even more insistent that the record show that all the procedures for notifying the corporate defendant of the suit against it have been met.²⁶⁵ The court held the original citation deficient for failing to instruct the sheriff whether it was to be served on the president, a vice president, or the registered agent.²⁶⁶ Nor did it deem service on the secretary of state sufficient even though the record contained a certificate by that official

though the facts are not clear, there was some indication the defendant was conducting its principal business activities in the forum county; if so, the "principal office" exception seems to have been overlooked.

²⁵⁹ *Mobil Oil Corp. v. Smith*, 482 S.W.2d 398 (Tex. Civ. App.—Waco 1972).

²⁶⁰ TEX. REV. CIV. STAT. ANN. art. 1995, subd. 27 (1964).

²⁶¹ 482 S.W.2d at 400.

²⁶² Under the statute, service can be made on the secretary of state, assistant secretary of state, or any clerk having charge of the corporation department by delivering to and leaving with any of those officials *duplicate copies* of the process. One of the copies is then forwarded by registered mail, addressed to the corporation at its registered office. TEX. BUS. CORP. ACT ANN. art. 2.11(B) (1956).

²⁶³ 485 S.W.2d 932 (Tex. Civ. App.—Houston [1st Dist.] 1972).

²⁶⁴ *Hanover Modular Homes of Taft, Inc. v. Corpus Christi Bank & Trust*, 476 S.W.2d 97 (Tex. Civ. App.—Corpus Christi 1972).

²⁶⁵ *E.g.*, *W.A. Green Co. v. Cope*, 466 S.W.2d 860, 861 (Tex. Civ. App.—Dallas 1971); *Anglo Mexicana de Seguros, S.A. v. Elizondo*, 405 S.W.2d 722, 725 (Tex. Civ. App.—Corpus Christi 1966), *error ref. n.r.e.*; *Ponca Wholesale Mercantile Co. v. Alley*, 378 S.W.2d 129, 132 (Tex. Civ. App.—Amarillo 1964), *error ref. n.r.e.*; *United States Leasing Corp. v. Centennial Liquor Stores, Inc.*, 368 S.W.2d 951, 952 (Tex. Civ. App.—Dallas 1963); *Investors Diversified Serv., Inc. v. Bruner*, 366 S.W.2d 810, 813 (Tex. Civ. App.—Houston 1963), *error ref. n.r.e.*; *Texaco, Inc. v. McEwen*, 356 S.W.2d 809, 813 (Tex. Civ. App.—Dallas 1962), *error ref. n.r.e.*

²⁶⁶ TEX. BUS. CORP. ACT ANN. art. 2.11(A) (1956).

that two copies of the citation had been served on him with one copy forwarded to the corporation in care of its registered agent in compliance with article 2.11(B). First of all, the plaintiff failed to show that the defendant had failed to appoint or maintain a registered agent or that he could not be found so as to permit service on the secretary of state. Secondly, the record did not show duplicate copies of the citation had been served on the secretary of state, an assistant secretary of state, or the clerk in charge of the corporation department in that office. The secretary of state's certificate was conclusory, did not show in what capacity he had been served, or the title of the person upon whom actual service was made, and failed to prove compliance with the rules setting out the requisites for, and return of, citation.²⁶⁷ Granting the soundness of the court's view that the conditions precedent to substituted service must first be proven, its rather cavalier treatment of the secretary of state's certificate seems overly technical. A plaintiff is hardly in a position to dictate what that official must certify with respect to the manner his office receives and forwards process, although presumably in light of this decision, his certification will now have to be more explicit, at least to support a default judgment.

Suits by Foreign Corporation. A foreign corporation which conducts intrastate business in Texas must obtain a certificate of authority to transact such business unless its activity is one of those specified in the TBCA as not constituting the doing of business here.²⁶⁸ Failure to qualify when required can result in the foreign corporation being barred from initiating litigation in the Texas courts until a certificate of authority has been issued.²⁶⁹ A threshold inquiry when a foreign corporation sues a Texas defendant in a Texas court is whether it is privileged to use a Texas tribunal to prosecute its cause of action.²⁷⁰ But how that inquiry is answered or whether it will be made at all depends on how or if the parties raise the issue.

In one of the survey cases,²⁷¹ a foreign corporation without a permit to do business in Texas was permitted to maintain its suit because its claim arose through business transacted in interstate commerce,²⁷² even though the defendant filed a plea in abatement questioning its power to bring the action. The fact the plaintiff's pleading shows it is a foreign corporation is not enough to bar the suit; the burden is on the defendant not only to allege the incapacity through a plea in abatement, but also to prove facts which show

²⁶⁷ TEX. R. CIV. P. 101, 107.

²⁶⁸ TEX. BUS. CORP. ACT ANN. art. 8.01(B) (Supp. 1972).

²⁶⁹ *Id.* art. 8.18(A).

²⁷⁰ A foreign corporation barred from suing in a state court because it has not qualified to do business there is also barred from maintaining a diversity action in federal court. *Woods v. Interstate Realty Co.*, 337 U.S. 535, 538 (1944); see C. WRIGHT, *supra* note 39, at 176.

²⁷¹ *Ero Indus., Inc. v. Be-In Buttons Co.*, 473 S.W.2d 677 (Tex. Civ. App.—Houston [1st Dist.] 1971).

²⁷² TEX. BUS. CORP. ACT ANN. arts. 8.01(B)(9), (10) (Supp. 1972) (excluding business in interstate commerce and isolated transactions completed within 30 days from class of activities that might require qualification).

that the corporation cannot maintain the action.²⁷³ The defendant's allegations, although sworn to, will not constitute proof.

The San Antonio court of civil appeals reached a similar conclusion in another case,²⁷⁴ in which the court determined that a plea in abatement dismissing a foreign corporation's action for not having qualified had been improperly sustained, but without much discussion of the point. The court ruled that an agreement to furnish shelving for a university library was sufficiently interstate in character to come under article 8.01(B)(9) of the TBCA even though the plaintiff foreign corporation procured wood-end panels for the shelving it furnished from a Texas concern.

²⁷³ E.g., *Truhe Box Co. v. Jandrew*, 346 S.W.2d 430, 432 (Tex. Civ. App.—San Antonio 1961), *error ref. n.r.e.*; *Rosenthal v. American Photocopy Equip. Co.*, 333 S.W.2d 448, 449 (Tex. Civ. App.—Houston 1960), *error dismissed*; *Roy Mitchell Contracting Co. v. Mueller Co.*, 326 S.W.2d 522 (Tex. Civ. App.—Texarkana 1959), *error ref. n.r.e.*; *Caples v. Dearborn Stove Co.*, 231 S.W.2d 669, 672 (Tex. Civ. App.—Dallas 1950), *rev'd on other grounds*, 149 Tex. 563, 236 S.W.2d 486 (1951).

²⁷⁴ *Estey Corp. v. St. Mary's Univ.*, 470 S.W.2d 138 (Tex. Civ. App.—San Antonio 1971).