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Recent Developments in Texas Corporation Law - Part I

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The past year witnessed a number of innovative developments in Texas corporation law, due primarily to a major overhaul of the Texas Business Corporation Act (TBCA) and related statutes. In addition to a variety of changes designed to further modernize the TBCA, the close corporation was dealt with specifically by name for the first time and the basic rules relating to shareholders' preemptive rights, derivative suits, and corporate guaranties were codified. The Texas Securities Act was amended to strengthen its administrative enforcement and penal sanctions. Corporate criminal responsibility and prosecution became a reality with enactment of the new Texas Penal Code and companion amendment of the Code of Criminal Procedure. Case law developments, on the other hand, were much less dramatic, although there were several important decisions on shareholder voting, dividends, and repurchase of shares.

The TBCA amendments were prepared by the Committee on Revision of Corporation Law of the State Bar Section on Corporation, Banking and Business Law (hereafter referred to as the Bar Committee). Except for its proposed liberalization of a corporation's power to indemnify its directors or officers, the Bar Committee's handiwork came through the legislative process virtually unaltered. The primary impetus for revision came from the large

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* Editor's Note: This Article is an expanded version of what would otherwise have been the Corporations section of the 1974 Annual Survey of Texas Law. It is in two parts: Part I contains sections I-V infra. Part II will appear in the Winter issue, 28 Southwestern Law Journal No. 5, and will contain sections VI and VII, which deal with the topics of "Corporate Finance" and "Other Developments." The latter topic includes coverage of developments under the Texas Securities Act.

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number of changes that had been made since 1955 in the Model Business Corporation Act, the basic guide for the original TBCA. In addition, a great many states (including such bellwether jurisdictions in the field of corporation law as Delaware, New Jersey, New York, and Pennsylvania) substantially revised their corporation acts in the intervening years, with several giving special consideration to problems of the close corporation. Thus, beginning in 1969 and with greater effort in 1971 and 1972, the Bar Committee undertook an analysis of the TBCA, comparing it with the 1969 revision of the Model Act and modern legislation elsewhere. In general, those changes in the Model Act which were deemed desirable for Texas formed the basis for most of the Bar Committee’s proposals, although the Delaware and Maine laws provided much of the inspiration for the new close corporation provisions. The Bar Committee also sponsored an expansion of the guaranty power set out in the Texas Miscellaneous Corporation Laws Act (TMCLA) and the repeal of several antiquated statutes relating to judicial jurisdiction over foreign corporations that were considered inconsistent with comparable provisions in the TBCA and the Texas long-arm statute.

In this survey, the TBCA and other changes are discussed by subject rather than in numerical order, as they have been competently treated seriatim elsewhere. Because of their number, only the more significant amendments are dealt with at length here.

I. CORPORATE STRUCTURE, ORGANIZATION, PURPOSES, AND POWERS

**Organic Documents.** The articles of incorporation and bylaws comprise the fundamental documents that prescribe within permitted legal limits a corporation’s scope of operations and basic internal structure and delineate the re-

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11. The Model Business Corporation Act is the product of the Committee on Corporate Laws of the Section on Corporation, Banking & Business Law of the American Bar Association. Patterned originally on the Illinois Business Corporation Act of 1933, the Act was first published in 1950. 1 ABA MODEL BUSINESS CORPORATION ACT ANNOTATED 3 (2d ed. 1971) [hereinafter cited as ABA MODEL BUS. CORP. ACT ANN. 2d]. It was largely that version which was used to structure the TBCA. Carrington, The Texas Business Corporation Act as Enacted and Ten Years Later, 43 Texas L. Rev. 609, 612 (1965); Carrington, A Corporation Code for Texas, 10 Ark. L. Rev. 28, 34 (1955); Carrington, Experience in Texas With the Model Business Corporation Act, 5 Utah L. Rev. 292, 295 (1957). After several piecemeal changes, the Model Act was substantially revised in 1969. 1 ABA MODEL BUS. CORP. ACT ANN. 2d, at 4; Scott, Changes in the Model Business Corporation Act, 24 Bus. Law. 291 (1968). Many of the 1973 amendments to the TBCA are based on these revisions.


lationship between the shareholders and the corporation. Because of the importance of these documents, the law establishes criteria for their content and sets bounds on how and by whom they can be altered. Historically, only the shareholders possessed the power to amend these instruments, but in recent years there has been a noticeable shift toward granting the power to the directors, especially with regard to the bylaws. Modern legislation often requires that amendments to the articles originate with the board and has increasingly lessened the percentage of shares needed for ultimate approval. This developing pattern is evident among several of the 1973 TBCA amendments that deal with the articles and bylaws.

**Articles of Incorporation and Amendments Thereto.** To accommodate the new close corporation articles, a subsection has been added to article 3.02 to authorize inclusion in the articles of incorporation of provisions that allow the shareholders of a close corporation to manage its affairs in lieu of a board of directors or that give one or more of its shareholders an option to dissolve the corporation. Similar authorization was added to article 4.01 to permit an existing corporation to amend its articles to take advantage of the same close corporation privileges or later to eliminate them. Because of their innovative nature, any of the close corporation provisions being added or deleted by amendment must be approved by a proper percentage of each class.

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20. Cary 156.


24. Id. art. 3.02(A)(9).

25. Id. arts. 4.01(B)(18), (20).

26. Id. arts. 4.01(B)(19), (20).
of shares as well as the shareholders overall.

Another change of significance allows the articles of incorporation to be amended by a vote of the holders of less than two-thirds of the shares but no less than a majority, if the articles so provide. The amendment is a compromise between the 1969 revision of the Model Act, which, to be "in accord with contemporary practices," had shifted from its former two-thirds requirement to the fashionable majority vote sanctioned by more permissive corporation codes, and the long-standing two-thirds requirement of the TBCA. If the articles are silent, the two-thirds vote is still required; this is in contrast to the Model Act and the statutory provisions of a majority of other jurisdictions which require the articles to specify a greater number than a majority if that is desired. At the same time, the permission previously given to require an even greater number of votes than two-thirds to amend if provided for in the articles remains unchanged. Permitting the reduction to a majority vote makes some sense for a large publicly held corporation that might have difficulty in getting a sufficient number of proxies returned for a two-thirds or greater approval, but its desirability for smaller

27. Id. arts. 403(B)(11)-(13). Section C of this article was repealed; this section denied the class voting privilege to amendments increasing the number of shares or altering the relative priorities of a class if the articles permitted such changes to be made within specific limitations and restrictions. Ch. 545, § 32, [1973] Tex. Laws 1507. See text accompanying notes 273-88 infra.

28. "Whenever, with respect to any action to be taken by the shareholders of a corporation, the articles of incorporation require the vote or concurrence of the holders of a greater or lesser number of shares, or of any class or series thereof, than is required by this Act with respect to such action, the provisions of the articles of incorporation shall control, provided the lesser number constitutes a majority or more." Tex. Bus. Corp. Act Ann. art. 9.08 (Supp. 1974) (emphasis added).

29. ABA MODEL BUS. CORP. ACT ANN. 2d, § 59(c).

30. Id. at 255.


32. ABA MODEL BUS. CORP. ACT ANN. 2d, § 143. See, e.g., DEL. CODE ANN. tit. 8, § 242 (Supp. 1971); N.Y. BUS. CORP. LAW § 803(a) (McKinney Supp. 1973); PA. STAT. ANN. tit. 15, § 1805(A) (Supp. 1974). Louisiana and Ohio provide another statutory alternative: a two-thirds vote is required, but the articles can provide for a lesser number, but no less than a majority. LA. REV. STAT. ANN. § 12.31(B) (1969); OHIO REV. CODE ANN. § 1701.71 (Page 1964). Tennessee calls for approval by the holders of a majority of outstanding shares or two-thirds of all shares whose holders are present or represented at the meeting at which the vote is taken. TENN. CODE ANN. § 48-302(1)(c) (Supp. 1973). See generally 2 ABA MODEL BUS. CORP. ACT ANN. 2d, § 59, ¶ 3.03(5), at 257; G. HORSTEIN, CORPORATION LAW AND PRACTICE 154 (1959) [hereinafter cited as HORSTEIN].

33. TEX. BUS. CORP. ACT ANN. art. 9.08 (1956).

34. Cf. N. LATTIN, R. JENNINGS & R. BUNBAUM, CORPORATIONS, CASES AND MATERIALS 387 (4th ed. 1968); Note, State Regulation of Corporate Practice for Electing Directors, 58 YALE L.J. 795, 798 (1949). Several brief stories reported within the space of a month in the Wall Street Journal in 1968 illustrate this point. Though shareholders of Royal Industries of Pasadena, California, mustered the simple majority vote needed to increase the company's authorized shares, the proxies received fell short of the two-thirds majority needed to change the company's state of incorporation to Delaware from California. Wall St. J., April 26, 1968, at 13, col. 2. Alpha Portland Cement Co. of Easton, Pennsylvania, dropped its effort to authorize a new class of preferred, eliminate preemptive rights, and permit two-thirds of the shares present at a meeting to authorize actions requiring a two-thirds vote of outstanding shares, because proxies for only 63% instead of the needed 66.6% of the shares needed for approval had been returned. Wall St. J., April 1, 1968, at 4, col. 3. Standard Kollsman Industries, Inc. of Syosset, New York, failed to win approval of a proposed new issue of preferred shares because proxies for fewer than the two-thirds vote needed had been re-
corporations where dangers of abuse of the rights of minority shareholders are more prevalent is doubtful.\textsuperscript{35} Despite the need for a specific provision in the articles to authorize a lesser percentage, which would require a two-thirds vote for its approval as an amendment, a majority-vote proviso can easily be made part of the original articles by the promoters or can be added thereto while the corporation is in their control before any shares are publicly issued.\textsuperscript{36} As a consequence, the ability of future minority shareholders to block an amendment that adversely affects their interests can be readily diminished.

Restated Articles of Incorporation. One of the useful features of the TBCA allows a corporation that has repeatedly amended its articles of incorporation over the years to restate them so that all the changes and supplementation can be found in a single document.\textsuperscript{37} Heretofore such action required shareholder approval by a vote of the holders of two-thirds or more of the outstanding shares whether the restatement included additional amendments or not.\textsuperscript{38} This has been changed so that now if the restatement makes no further amendment of the articles, the directors alone need authorize the restatement procedure.\textsuperscript{39} If, however, the restated articles include an amendment, the directors' resolution proposing the same for shareholder approval must state that except for the designated amendment the restated articles correctly set out the text of the original articles as previously amended and that the restated articles together with the proposed amendment will supersede the original articles and prior amendments thereto.\textsuperscript{40}

Received. A company spokesman said the number of shares cast in favor fell a few percentage points below the minimum required. The situation was attributed to the company's failure to seek approval far enough in advance and to the fact that a large number of shares were held in street names and beneficial owners had not sent the necessary authorization to their brokers to vote the shares. Wall St. J., May 3, 1968, at 3, col. 5.

35. On the desirability of higher rather than lower percentages for shareholder action as to fundamental changes in the corporate structure of a close corporation, thus affording a minority shareholder a "veto" power to protect himself, see 1 F. O'NEAL, CLOSE CORPORATIONS: LAW AND PRACTICE § 4.10 (1971) [hereinafter cited as F. O'NEAL, CLOSE CORPORATIONS]. See generally 20 R. HAMILTON, TEXAS PRACTICE: BUSINESS ORGANIZATIONS § 686 (1973) [hereinafter cited as R. HAMILTON, TEXAS BUSINESS ORGANIZATIONS]; HENN 525; 1 HORNSTEIN § 129; W. PAINTER, CORPORATE AND TAX ASPECTS OF CLOSELY HELD CORPORATIONS § 3.6 (1971) [hereinafter cited as W. PAINTER, CLOSELY HELD CORPORATIONS]; Pelletier & Marsh, Incorporation Planning in Texas, 23 SW. L.J. 820, 843 (1969).

36. See TEX. BUS. CORP. ACT ANN. art. 4.02(A)(1) (Supp. 1974), permitting the board of directors named in the original articles of incorporation to amend the articles if no shares have been issued. See text accompanying note 75 infra.

37. TEX. BUS. CORP. ACT ANN. art. 4.07 (Supp. 1974).

38. TEX. BUS. CORP. ACT ANN. art. 4.07(A) (1956), as amended, (Supp. 1974). The statute stated that a corporation could restate its articles "by following the procedure to amend the articles of incorporation provided by this Act." The 1973 amendment adds the parenthetical phrase, "(except that no shareholder approval shall be required where no amendment is made)."

39. TEX. BUS. CORP. ACT ANN. art. 4.07(A) (Supp. 1974); see note 38 supra. The effect of the change is to simplify greatly the restatement process when no amendment is made; it also "eliminates the expense of notifying shareholders and obtaining their approval of an action that is essentially meaningless to them." Comment of Bar Committee to Art. 4.07, 3A TEX. REV. CIV. STAT. ANN. 119 (Supp. 1974). The Model Act allows the directors to restate the articles, but unlike its previous version in former § 59, upon which the Texas provision is based, does not permit an amendment to be made via the restatement. ABA MODEL BUS. CORP. ACT ANN. 2d, § 64. The Texas procedure seems preferable.

40. TEX. BUS. CORP. ACT ANN. art. 4.02(A)(1) (Supp. 1974).
**Incorporation by Reference.** As originally enacted, the TBCA provided that if a corporation issued preferred shares or series thereof or limited or denied preemptive rights or imposed restrictions on transferability of shares, such preferences, limitations, denials, or restrictions had to be set out in full or in summary form on the face or back of the share certificates. Because statements of preferences or restrictions on transfer are often quite lengthy, the original requirement posed the practical problem of squeezing a detailed yet legible statement on essentially a small piece of paper. If a summary were used, there was some concern whether it would accurately reflect the underlying provisions. As a consequence, article 2.19 was amended in 1957 by adding a section F that permitted preferences, limitations, restrictions, etc., whether found in the articles or bylaws, to be referred to on the share certificates rather than be set out in full or summary form, provided any applicable bylaw provision or any resolution of the directors fixing the relative rights and preferences of a series of preferred was filed with the secretary of state by following the procedure outlined in the amendment. This 2.19(F) filing, as it became known, was also extended to allow filing of an agreement restricting transferability to be incorporated by reference into the articles or bylaws if required to be set out therein by the Act. Interestingly enough, nothing in the Act directly required inclusion of such agreements in the articles or bylaws; nevertheless they were often filed, not

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43. Id.


45. “To the extent that this Act requires that any agreement restricting the transfer of shares of a corporation be set forth within the articles of incorporation or by-laws of a corporation, such requirement shall be fully complied with by a reference to such agreement in the articles of incorporation or by-laws; provided that such agreement shall have theretofore been filed with the Secretary of State in accordance with the provisions of this Article.” Ch. 54, § 2, [1957] Tex. Laws 111, as amended, Tex. Bus. Corp. Act Ann. art. 2.19(F)(1) (Supp. 1974).

46. Such inclusion may have indirectly been authorized by Ch. 64, art. 2.22, [1955] Tex. Laws 253, as amended, Tex. Bus. Corp. Act Ann. art. 2.22 (Supp. 1974). Section A of that article (before its 1973 amendment) permitted a corporation to impose restrictions on transferability “if each such restriction is expressly set forth in the articles of incorporation or by-laws” and on the stock certificates. Section B, however, stated that in addition to any other restrictions which the corporation might reasonably impose, in the above manner, restrictions giving the corporation or its shareholders of record a preemptive or prior right to purchase shares or giving the corporation or any other person or persons an option or first refusal on such shares were also permissible. Since any such right given the corporation, if not set out in the articles or bylaws, presumably would be provided for in an agreement to which the corporation was a party, it is arguable that such an agreement would have been required to be made part of the articles or bylaws or incorporated by reference therein to permit its enforcement by the corporation. See Irwin v. Prestressed Structures, Inc., 420 S.W.2d 491, 494 (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), so intimating. Alternatively, it can be argued, as a student commentator pointed out, that section A referred only to unilaterally im-
only for that purpose, but also to permit a reference to the restrictions on transfer they imposed to be placed on the share certificates, even though again article 2.19(F) contained no such specific authorization.\(^{47}\)

The 1973 amendments extensively revised article 2.19,\(^{48}\) including a new section F to replace the former section.\(^{49}\) Because part of the revision of article 2.19 provided for alternative statements that could be utilized to shorten the required legend on share certificates relative to preferences, limitations of preemptive rights, or transfer restrictions,\(^{50}\) the Bar Committee felt there was no longer a need for their separate filing to permit incorporation by reference on the share certificates.\(^{61}\) Nevertheless the committee decided there was merit in allowing often lengthy shareholders' agreements restricting transferability of shares to be incorporated by reference within the articles or bylaws and hence determined to salvage that remaining part of the old section by rewriting it as a new section F that would clarify some of the former ambiguities.\(^{62}\) At the same time, section E was amended, first as a saving clause to validate outstanding share certificates that contained references to other documents under the former procedure, and secondly, to prohibit the practice in the future whether in connection with the issue or transfer of shares "or otherwise."\(^{63}\)

\(^{47}\) See 20 R. HAMILTON, TEXAS BUSINESS ORGANIZATIONS § 676; Doyt & Parker 1014; Pelletier & Marsh, supra note 35, at 841. Although article 2.19(F)(1) did not specifically state an agreement incorporated by reference into the articles or bylaws thereunder could also be referred to on stock certificates, except as inferred by the first sentence of section F(1), it was undoubtedly the intent of the Bar Committee that such could be done under the statute. Thus the committee stated as its opinion that "the provisions of the last sentence of paragraph (1) of Section F will permit the incorporation by reference of all or part of agreements restricting the transfer of shares not only in stock certificates but also in the articles of incorporation and by-laws" if article 2.19(F) were otherwise complied with. Comment of Bar Committee to Art. 2.19, 3A TEX. REV. CIV. STAT. ANN. 43 (Supp. 1972).


\(^{49}\) Former section F was not repealed, as stated in the Comment of the Bar Committee, 3A Tex. Rev. Civ. Stat. Ann. 53 (Supp. 1974), but was substantially revised as indicated in the text. At one point in its deliberations, the Bar Committee considered eliminating the incorporation by reference procedure entirely and present sections G and H were designated sections F and G, respectively. When present section F was approved by the committee, it was regarded as new legislation and assigned its section letter only because the former section which it would replace also dealt with incorporation by reference. Hence in the committee's view, as reflected in its Comment, the old section was being repealed.

\(^{50}\) TEX. BUS. CORP. ACT ANN. arts. 2.19(B), (G) (Supp. 1974).

\(^{51}\) Cf. Comment of Bar Committee to Art. 2.19, 3A TEX. REV. CIV. STAT. ANN. 53 (Supp. 1974); Doyt & Parker 1014.

\(^{52}\) See note 49 supra.

\(^{53}\) TEX. BUS. CORP. ACT ANN. art. 2.19(E) (Supp. 1974).
As rewritten, article 2.19(F) allows a corporation that has adopted a bylaw or is party to an agreement restricting transferability to incorporate either document into its articles of incorporation or the agreement into its bylaws by complying with the proper procedure to amend the articles or bylaws and by filing the bylaw (if incorporated into the articles) or agreement (if incorporated into either) with the secretary of state.54 By permitting a bylaw as well as an agreement to be incorporated by reference into the articles, the new section goes beyond the old. By specifying that the effect of such incorporation by reference is tantamount to an amendment of the articles or bylaws, the Bar Committee sought to eliminate the somewhat dubious practice formerly followed by the secretary of state that allowed an agreement restricting transferability to be incorporated by reference into the articles through a 2.19(F) filing without requiring that the reference made in the articles to the agreement be added through the formal amendatory procedure set out in the Act.55 All that the form previously promulgated by the secretary of state for the statement of a resolution authorizing incorporation by reference specified was that the document being filed was a true and correct copy and that its incorporation by reference was duly authorized by the board of directors.56 Although the form proposed for use for present 2.19(F) filing suggests that the corporation's word may again be taken that the provisions of the Act for amending the articles or bylaws have been complied with,57 the corporation division's current policy is to require an amendment to the articles before accepting the statement if an examination of the corporation's file shows no reference to or authority for inclusion of the agreement in the original or amended articles.58 In view of the substantial disparity between

54. Id. art. 2.19(F).
55. Comments on Proposed Forms Under Article 2.19(F), distributed by William D. Kimbrough, Chief, Corporation Division, Secretary of State, at a meeting of the State Bar Committee on Revision of Corporation Law, Austin, Texas, November 10, 1973. The former practice seems even stranger, from the standpoint of collection of revenues, in view of the substantial difference in the fees collected for filing the 2.19(F) statement and articles of amendment. See note 59 infra. The only comparable filing permitted under the Act that affects the articles of incorporation without formal amendment (and has the same filing fee of $10 as the 2.19(F) statement) is the resolution which is filed by the board of directors whenever a series of preferred or special class of shares are to be issued and which sets out the relative rights and preferences of the series. Tex. Bus. Corp. Act Ann. art. 2.13(D) (1956). However, the articles must expressly authorize the directors to issue such classes in series (or have generally authorized their issuance) and the statute expressly states that upon such filing the resolution becomes an amendment to the articles of incorporation. There is no comparable statement in article 2.19(F).
57. Three proposed forms for use under article 2.19(F) were distributed at the Bar Committee meeting referred to in note 55 supra. One was a statement of incorporation by reference of a bylaw into the articles; another for incorporation of an agreement into the articles; and the third for incorporation of an agreement into the bylaws. The first two forms require that a statement be made that the incorporation by reference has been authorized by the board and that "the provisions of the act for amendment of Articles of Incorporation have been complied with."
58. Interview with William D. Kimbrough, Chief, Corporation Division, Secretary of State, March 4, 1974.
the fee for filing articles of amendment and a 2.19(F) statement and the fact that the agreement can just as readily be made part of the bylaws, some counsel may elect to save their clients the ninety-dollar difference by having the agreement incorporated by reference into the bylaws. On the other hand, some thought should be given to the fact that making the agreement part of the articles protects the parties more effectively against later changes. If that is an important consideration, the money saved by going the bylaw route may well prove to be penny-wise, pound-foolish.

Amending the Bylaws. As the document prescribing the corporation’s internal government and methods of operation, the bylaws play an important role in defining the authority of the shareholders, directors, and officers to act in its behalf. Indeed, the TBCA specifies a number of corporate matters to be resolved in the bylaws alone or, alternatively, with the charter. As a consequence, the ability to alter, amend, or repeal the bylaws means having effective power to mold the corporation along desired lines. Until the 1973 amendments, the shareholders held that power, although they could delegate it to the board. With the amendments, the delegation to the board has become the law.

As article 2.23 has been amended, the directors still adopt the initial bylaws, as before. The difference is that they may also repeal, change, or add to the bylaws in their discretion unless the articles reserve that power in the shareholders. Nevertheless, the shareholders’ residual power over the by-

59. The fee for filing articles of amendment is $100, TEX. BUS. CORP. ACT ANN. art. 10.01(A)(2) (Supp. 1974); for filing a statement of provisions incorporated by reference, $10, id. art. 10.01(A)(14).

60. See HENN 564; 1 F. O’NEAL, CLOSE CORPORATIONS §§ 3.79, 7.07a.

61. E.g., imposing restrictions on the transfer of shares, TEX. BUS. CORP. ACT ANN. art. 2.22(B) (Supp. 1974); setting time and place for annual shareholders’ meeting, id. art. 2.24(B) (1956); setting record date for determination of shareholders eligible to receive dividends or vote, id. art. 2.26(A); classifying directors and fixing their terms when the board consists of nine or more directors, id. art. 2.33; providing for notice of directors’ meetings, id. art. 2.37(B); prescribing manner of election of officers and establishing their authority and scope of duties, id. art. 2.42. For a complete listing see 1 H. KENDRICK & J. KENDRICK, TEXAS TRANSACTION GUIDE § 3.07[2] (1972).

62. E.g., prescribing qualifications for directors, TEX. BUS. CORP. ACT ANN. art. 2.31 (1956); establishing greater than a majority vote for action at shareholders’ meetings, id. art. 2.28; fixing or providing manner of determining number of directors after initial board and prescribing quorum and voting requirements for action by directors, id. art. 2.33 (Supp. 1974); creating executive or other committees, id. art. 2.36; restricting the authority of the directors to take action without a meeting, id. art. 9.10(B). For a complete list see 1 H. KENDRICK & J. KENDRICK, supra note 61, § 3.07[2]. The articles of incorporation, of course, can include any matter which the TBCA allows or permits to be set out in the bylaws. TEX. BUS. CORP. ACT ANN. art. 3.02(A)(10) (Supp. 1974).


63. “The power to alter, amend, or repeal the bylaws or to adopt new bylaws shall be vested in the shareholders, but such power may be delegated by the shareholders to the board of directors.” Ch. 64, art. 2.23, [1955] Tex. Laws 239, as amended, Tex. BUS. CORP. ACT ANN. art. 2.23 (Supp. 1974).

64. TEX. BUS. CORP. ACT ANN. art. 2.23 (Supp. 1974).

65. The draftsmen of section 27 of the Model Business Corporation Act, to which amended article 2.23 is now identical, rationalized their decision to vest the power to amend the bylaws in the directors as “consistent with the modern tendency in corpora-
laws has been preserved by a specification that any alteration made by the directors remains "subject to repeal or change by action of the shareholders." This recognition of the shareholders' right to veto or undo the directors' handiwork goes far, of course, in mitigating the shift in power, even though the language employed leaves some doubt as to whether shareholders can adopt an entirely new bylaw.

See generally ABA Model Bus. Corp. Act Ann. 2d, § 27, ¶¶ 3.01-04; 2 Z. Cavitch, supra note 21, § 62.04[1]; Note, Exclusive Control of the Adoption and Amendment of By-Laws or Regulations by the Corporate Directors, 25 U. Cin. L. Rev. 362 (1956).

66. This reservation, found in section 27 of the Model Business Corporation Act, was not contained in the Bar Committee's proposal when introduced, S.B. 202, 63d Legis., Reg. Sess. § 14 (1973), but was added at the suggestion of Professor Robert Hamilton by legislative committee amendment. Even when the power to amend the bylaws has been delegated to the directors, the better view has always been that the shareholders retain the power to override the authority granted the directors and make their own changes in the bylaws. Rogers v. Hill, 289 U.S. 582, 589 (1933); Auer v. Dressel, 306 N.Y. 427, 118 N.E.2d 590 (1954); F. EMERSON & F. LATCHAM, SHAREHOLDER DEMOCRACY 99 (1954); 2 L. Loss, Securities Regulation 903 (2d ed. 1961).

67. Professor Hamilton believes the limiting of the shareholders' reserved power to repeal or to make changes, or not adoption of new bylaws, is inadvertent, "since one would expect the power of shareholders over the bylaws to be at least as broad as the power of directors." 19 R. HAMILTON, TEXAS BUSINESS ORGANIZATIONS § 279. Nevertheless, the difference in terminology could well be attributed to a desire to give the directors primary authority for determining the content of the bylaws, subject only to a limited veto by the shareholders, in order to strengthen still further their power of management. See note 65 supra. Georgia and New Jersey, for example, in revising their corporation laws, apparently recognized the limiting effect of the Model Act language and chose to follow the Virginia statute which, after giving the directors the power to adopt and amend the bylaws, provides: "But bylaws made by the board of directors may be repealed or changed, and new bylaws made, by the stockholders, and the stockholders may prescribe that any bylaw made by them shall not be altered, amended, or repealed by the directors." Ga. Code Ann. § 13A:2-9 (1969). According to the Comment to the Georgia statute, prepared by Professor Pasco M. Bowman II of the University of Georgia, the Virginia-type language gives the directors the power to make bylaws that govern internal housekeeping, "while at the same time permitting the shareholders, when their concern is aroused, to exercise both a veto and new legislation power." 22 Ga. Code Ann. 119 (1970) (emphasis added). Similarly, the Commissioners' Comment to the New Jersey statute notes that the last proviso permits the shareholders to lock in any bylaw from subsequent alteration
In reality, probably very little has been changed by the revision. Even under the former law, while the directors could not be granted the amender-
tory power in the original articles of incorporation, it could easily be dele-
ted to them at any time after the initial issuance of shares, especially during
the interim when the organizers were in control. The only significant impact
will be on those corporations whose bylaws for some reason or other do not
adequately provide how they are to be amended.

Organization: Role of Incorporators. As originally enacted, the TBCA specified a few limited duties the incorporators were required or permitted to per-
form. Thus, in addition to their primary function of signing, verifying, and
delivering the articles of incorporation to the secretary of state and in turn
receiving the certificate of incorporation once issued, the incorporators were
to call the organizational meeting of the board of directors named in the arti-
cles, and, if no business had been commenced and shares issued, the incor-
porators were granted power to amend the articles or dissolve the corpora-
tion. Under the 1973 amendments, their role and potential power have
been further diminished; correspondingly, the power of the first board has
been enhanced.

Now, a majority of the directors named in the articles call the organiza-
tional meeting of the board provided for in article 3.06. Similarly, if no
shares have been issued it is the directors and no longer the incorporators
who may amend the articles. Somewhat inconsistently, the incorporators

or repeal by the board. 14A N.J. REV. STAT. 99 (1969). In view of the ambiguity
implicit in the Model Act (and the Texas Act) provision, something along the lines
of the Virginia legislation should certainly be incorporated into article 2.23 just to make
certain the residual power the shareholders should always retain over corporate rule-
making is adequately preserved.

(holding provision in articles giving directors power to amend contra to article 2.23 and
thus to be regarded as surplusage); cf. Dixie Glass Co. v. Pollak, 341 S.W.2d 530 (Tex.
Civ. App.—Houston 1960), error ref. n.r.e. (bylaws gave both directors and shareholders
power to amend with each having power to alter or repeal bylaws made by other; facts
not clear whether shareholders or directors or both had approved same; subsequent
unanimous approval of long-term employment contract of officer by both shareholders
and directors treated as implied amendment of bylaws). See 19 R. HAMILTON, TEXAS
BUSINESS ORGANIZATIONS § 279, indicating that under article 2.23 before its amendment
a provision in the bylaws or articles giving the directors the power to amend was prob-
lably ineffective. But cf. id. § 280 where article VIII of the suggested bylaws gives the
directors, as well as the shareholders, the amenderary power. Possibly, as Professor
Hamilton suggests, a provision of this sort would have been upheld had the adoption
of the bylaws as a whole or the specific bylaw been ratified by the shareholders. Id.
§ 279. See also Pelletier, Incorporation Planning in Texas, 23 SW. L.J. 820, 847 n.165
(1969), quoting statistics to show that out of a sample of 1,000 charters filed in 1968,
11.3% contained a provision giving the directors the power to amend the bylaws. This,
four years after the Keating decision!

69. TEX. BUS. CORP. ACT ANN. art. 3.01 (1956).
70. Id. art. 3.03(B).
71. Ch. 64, art. 3.06, [1955] TEX. LAWS 239, as amended, TEX. BUS. CORP. ACT
ANN. art. 3.06 (Supp. 1974).
4.02(C), repealed, ch. 545, § 32, [1973] TEX. LAWS 1507.
73. Ch. 64, art. 6.01, [1955] TEX. LAWS 239, as amended, TEX. BUS. CORP. ACT
ANN. art. 6.01 (Supp. 1974).
74. TEX. BUS. CORP. ACT ANN. art. 3.06 (Supp. 1974).
75. Id. art. 4.02(A)(1). Section C of article 4.02, giving the incorporators the
power to amend the articles by a written unanimous consent if no shares had been is-
issued, was repealed. Ch. 545, § 32, [1973] TEX. LAWS 1507.
still retain the power to dissolve the corporation if no business has been commenced nor shares issued, but now presumably so may the directors.76

In light of the acknowledged pattern of eliminating the duties of the incorporators,77 it is surprising no change was made in the archaic requirement that there be at least three incorporators, two of whom have to be citizens of Texas, and all of whom must be twenty-one years old or more.78

These requisites seem especially chauvinistic and unenlightened in these days of societal mobility and youthful emancipation. The current trend is moving rapidly away from the traditional concept that corporateness can only be attained by at least a trinity of natural persons in favor of permitting a single incorporator to perform the role whether human or a legal entity.79

To continue to insist that there be at least three incorporators to create a corporation that conceivably could be governed by a one-man board of directors80 and all of whose stock may be owned by a single individual or entity makes little sense. It is equally incongruous to empower a Texas corporation to act as an incorporator in other states where allowed,81 but not

76. TEX. BUS. CORP. ACT ANN. art. 6.01 (Supp. 1974). The amendment also eliminates the two-year time limit for such dissolution. Through Bar Committee oversight, even though the directors alone approve such dissolution, the articles of dissolution must still recite that a majority of the incorporators elected that the corporation be dissolved, id. art. 6.01(A)(1)(g), and the certificate of dissolution is still to be delivered “to the incorporators or their representatives.” Id. art. 6.01(A)(3).

77. See Doty & Parker 1023.

78. TEX. BUS. CORP. ACT ANN. art. 3.01 (1956). The requirement that incorporators must be 21 years of age or more would seem to be indirectly amended by TEX. REV. CIV. STAT. ANN. art. 5923b (Supp. 1974), giving all the rights, privileges and obligations of majority to persons 18 years of age or older. Under the statute a law that extends a right, privilege, or obligation to a person on the basis of a minimum age of 21 years “shall be interpreted as prescribing a minimum age of 18 years.” Id. § 2. As a consequence, the secretary of state will accept articles that recite the incorporators are 18 years of age or more. 19 R. HAMILTON, TEXAS BUSINESS ORGANIZATIONS § 259, at 20 (Supp. 1974). By the same token, article 2.01 of the Texas Miscellaneous Corporation Laws Act (TMCLA), TEX. REV. CIV. STAT. ANN. art. 1302-2.01 (1962), permitting married women to serve as incorporators, shareholders, officers, or directors, has become obsolete in view of the full capacity married women are presently accorded by Texas law. TEX. Fam. CODE ANN. § 4.03 (1973).


See generally 3 Z. CAVITCH, supra note 21, § 62.03(1); HENN 220; Garrett, John Doe Incorporates Himself, 19 BUS. LAW. 535 (1964); Spoerri, One Incorporator, One Director, 19 BUS. LAW. 305 (1963).

80. See TEX. BUS. CORP. ACT ANN. art. 2.32 (Supp. 1974).

81. See id. art. 2.02(A)(18).
to so empower it in Texas.

**Purposes.** Prior to 1955, a Texas business corporation was generally limited to a single purpose that had to be statutorily authorized. In one of the more important changes made by the TBCA, a corporation was permitted to choose any number of lawful or non-prohibited purposes, with minor limitations, so long as they were set out fully in the articles of incorporation. A 1973 amendment carries Texas to the other end of the spectrum: It is now permissible to organize for any purpose or purposes “which may be stated to be, or to include, the transaction of any or all lawful business for which corporations may be incorporated” under the Act. Moreover, specific purposes need no longer be set out fully in the articles of incorporation. Despite the sweeping authorization thus granted, some consideration should be given, especially in drafting articles for small, closely-held businesses, whether such generality of corporate objects is desirable. There is something to be said for keeping the scope of some business ventures, particularly closely-held enterprises, within agreed bounds. Needless to say, adopting a comprehensive purpose clause of this sort virtually eliminates the ultra vires doctrine in its traditional sense.


84. The following combination of purposes are still prohibited: cattle-raising and meat packing; oil production and engaging directly in the oil and pipeline business. Tex. Bus. Corp. Act Ann. arts. 2.01(B)(3)(a), (b) (1956). These are vestiges of the old corporation law that were carried over into the TBCA to minimize opposition to adoption of the Act. See Comment of Bar Committee to Art. 2.01, 3A Tex. Rev. Civ. Stat. Ann. 19 (1956); Carrington, Experience in Texas With the Model Business Corporation Act, 5 Utah L. Rev. 292, 298 (1957). Even these prohibited combinations can probably be circumvented through use of subsidiary or affiliated corporations. Cf. State v. Swift & Co., 187 S.W.2d 127 (Tex. Civ. App.—Austin 1945), error ref. (meat packer not in violation of antitrust decree forcing it from cottonseed oil business through ownership of subsidiary engaged in same business). But see 19 R. Hamilton, Texas Business Organizations § 355, at 384-85.


87. Id. art. 2.01(A). Before its amendment, this section required the purposes of the corporation to be “fully stated” in the articles of incorporation.

88. See 1 F. O'Neal, Close Corporations § 3.10; C. Rohrlch, Organizing Corporate and Other Business Enterprises 296 (4th ed. 1967).

89. Comment of Bar Committee to Art. 2.01(A), 3A Tex. Bus. Corp. Act Ann. 9 (Supp. 1974); Doty & Parker 1011. However, no matter how expansive the corporation’s purpose clause, there remain a few transactions to which the ultra vires doctrine will continue to apply, mainly because of limits Texas law imposes on the exercise of certain corporate powers. These include: (1) Corporate guaranties; see, e.g., Cooper Petroleum Co. v. LaGloria Oil & Gas Co., 423 S.W.2d 645 (Tex. Civ. App.—Houston [14th Dist.] 1967), rev’d on other grounds, 436 S.W.2d 889 (Tex. 1969); Empire Steel Corp. v. Omni Steel Corp., 378 S.W.2d 905 (Tex. Civ. App.—Fort Worth 1964), error ref. n.r.e., noted in 43 Texas L. Rev. 792 (1965). But see text accompanying notes 105-46 infra. (2) Loans to directors or officers; see Tex. Bus. Corp. Act Ann. art. 2.02 (A)(6) (1956); cf. Whitten v. Republic Nat’l Bank, 397 S.W.2d 415 (Tex. 1965), noted in 20 Sw. L. J. 861 (1966). (3) Acquisition of excess real property; see TMCLA art. 4.01, Tex. Rev. Civ. Stat. Ann. art. 1302-4.01 (1962). See generally 19 R. Hamilton, Texas Business Organizations §§ 351-62; Brimble, Ultra Vires Under the Texas Business Corporation Act, 40 Texas L. Rev. 677 (1962).
General Powers. Several of the general powers enumerated in article 2.02(A) have been clarified or made more specific, although it is probable all the matters added or altered were reasonably implied within the powers granted by that article before its amendment. For example, the language of article 2.02(A)(11) now allows a Texas corporation to operate “within or without this State,” rather than “in any state, territory, district or possession of the United States, or any foreign country.”90 The change eliminates any question that might be raised respecting such activities as offshore exploration and drilling, maritime shipping, or, in the not too distant future, outer space.91 Similarly, current ambiguities in determining the existence of a state of war92 so as to allow a corporation to “make donations in aid of war activities”93 or “in time of war” to conduct any lawful business that will aid the government in the prosecution of the war94 has led to amendments deleting the war activities donation power95 and enlarging the corporation’s power to transact any lawful business the board finds “will be in aid of governmental policy.”96 This expansion of power is a significant one. A corporation whose management has a strong sense of social responsibility, for example, can now properly participate in governmentally-sponsored programs to combat such matters as poverty, crime, pollution, or discrimination without need for amending its articles to authorize such activities.97 Indeed, given the

91. See Comment of Bar Committee to Art. 2.01, 3A Tex. Bus. Corp. Act Ann. 13 (Supp. 1974); Doty & Parker 1012. Another reason for the change was to clear the ambiguity implicit in the term “foreign country” with respect to such areas as trustships under United Nations mandate or Antarctica. See 1 ABA Model Bus. Corp. Act Ann. 2d, at 154.
96. Id. art. 2.02(A)(15). The change in language will still allow the corporation to assist the Government in times of belligerency through donations or war activities but now makes clear it may also join in governmental efforts in domestic and other “policy areas.” Comment of Bar Committee to Art. 2.02, 3A Tex. Rev. Civ. Stat. Ann. 13, 14 (Supp. 1974); Doty & Parker 1012.
97. Scott, supra note 11, at 292. Aside from the narrower legal issue of whether a corporation has power to participate in programs that seek to solve or at least mitigate societal problems, whether governmentally-sponsored or not, there is the broader question of whether a business organization whose purported primary objective is to maximize the value of its owners’ investment therein should become involved at all in such matters. The developing body of writings on the propriety of such participation is becoming extensive. See, e.g., P. Blumberg, Corporate Responsibility in a Changing Society: Essays on Corporate Social Responsibility (1972); The Corporation in Modern Society (E. Mason ed. 1959); R. Eells, Corporate Giving in a Free Society (1956); N. Jacoby, Corporate Power and Social Responsibility (1973); H. Manne & H. Wallich, The Modern Corporation and Social Responsibility (1972);
broad scope of governmental interests these days, the provision comes close to
giving carte blanche authority to the directors to undertake almost any
endeavor they choose to pursue, so long as some relation to public policy
can be found.

A new power has been added that makes clear a corporation can organize,
join, or manage any partnership, joint venture, or other enterprise it may
enter, although such authority would seem to be implied in article
2.02(A)(7). In addition, it may serve as an incorporator in any other
jurisdiction permitting foreign corporations to serve as such. The specific
authorization to enter into a partnership should lay to rest for once and for
all the old common law view that a corporation cannot be a partner.

Another amendment sanctions the procurement of liability insurance on
behalf of present or former directors, officers, employees, or agents or persons
serving in any of those capacities in other enterprises at the corporation’s re-
quest even if the corporation might otherwise lack power to indemnify any
of these persons against liability under the Act.

Guaranty Power. For many years, the status of corporate guaranties con-
stituted a troublesome area of the Texas law. Much of the difficulty arose
from a narrow view the Texas courts took of the guaranty power. Insisting

Hacker, Do Corporations Have a Social Duty?, in THE CORPORATION IN THE AMERICAN
ECONOMY (H. Trebing ed. 1970); Hetherington, Fact and Legal Theory: Shareholders,
Managers and Corporate Social Responsibility, 21 STAN. L. REV. 248 (1969); Sommer,
Longstreth & Loomis, Corporate Social Responsibility Panel: The Role of the SEC, 28

98. TEX. BUS. CORP. ACT ANN. art. 2.02(A)(18) (Supp. 1974). Former subsec-
tions (18) and (19) (empowering corporations to dissolve and to exercise all powers
necessary or appropriate to carry out its purposes, respectively) have been renumbered
as subsections (19) and (20), respectively. Ch. 545, § 3, [1973] Tex. Laws 1486.

99. TEX. BUS. CORP. ACT ANN. art. 2.02(A)(7) (1956), authorizing the corporation
to acquire, among other securities, interests in partnerships. Cf. Port Arthur Trust Co.
v. Muldrow, 155 Tex. 612, 614, 291 S.W.2d 312, 314 (1956), noted in 35 TEXAS L. REV.
265 (1956) (noting, but not deciding whether this subsection changed the former hold-
ings of the Texas courts that a corporation cannot become a partner); compare with
Texas Uniform Partnership Act that includes corporations within its definition of per-
sons who may form a partnership. TEX. REV. CIV. STAT. ANN. art. 6132b, § 2 (1970).

See 19 R. HAMILTON, TEXAS BUSINESS ORGANIZATIONS § 121, at 108; Comment,

100. TEX. BUS. CORP. ACT ANN. art. 2.02(A)(18) (Supp. 1974); see text accom-
panying notes 71-75 supra.

101. See, e.g., Port Arthur Trust Co. v. Muldrow, 155 Tex. 612, 614, 291 S.W.2d
312, 314 (1956), noted in 35 TEXAS L. REV. 265 (1956) (dictum); Luling Oil & Gas
Co. v. Humble Oil & Ref. Co., 144 Tex. 475, 483, 191 S.W.2d 716, 722 (1945) (dic-
tum); Thomas v. Southern Lumber Co., 181 S.W.2d 111, 113 (Tex. Civ. App.—Waco
1944); Sabine Tram Co. v. Bancroft, 40 S.W. 837 (Tex. Civ. App. 1897), error ref. See
generally 19 R. HAMILTON, TEXAS BUSINESS ORGANIZATIONS § 121; 1 I. HILDEBRAND,
TEXAS CORPORATIONS 268; 1 HORNSTEIN § 117.

102. TEX. BUS. CORP. ACT ANN. art. 2.02(A)(16) (Supp. 1974). For further discus-
sion, see text accompanying notes 792-820 infra.

would have been added as a new article 2.02-1.

104. Wolf, supra note 9, at 537; see text accompanying notes 795-98 infra.
that only those guaranties shown to directly benefit the corporation are proper,\(^ \text{105} \) the courts refused to enforce guaranties for the benefit of customers,\(^ \text{108} \) employees,\(^ \text{107} \) or affiliated companies,\(^ \text{108} \) despite their demonstrable economic advantages in building customer good will, encouraging employee loyalty and tenure, or assisting related enterprises with their financing.\(^ \text{109} \) Enactment of the TBCA and other legislative changes alleviated the problem to some extent, primarily by curtailing use of the ultra vires defense, but even with these innovations, the law remained in a muddled state.

To begin with, despite the expansion of permissible purposes for which a Texas corporation can be formed under the TBCA,\(^ \text{110} \) a general business corporation cannot include the making of guaranties as one of its stated purposes. The reason given is that it would then be considered as engaged in the insurance business,\(^ \text{111} \) something prohibited under the Act.\(^ \text{112} \) Secondly, while article 2.02(A) of the Act enumerates a variety of powers every business corporation may utilize to carry out the objects or purposes for which it was formed,\(^ \text{113} \) the guaranty power is not among them.\(^ \text{114} \) Even if it were, any exercise of the power would also be governed by article 2.06 of the Miscellaneous Corporation Laws Act that, in the words of the Texas Constitu-

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105. The view was based on the belief that a corporation should not lend its credit to another because it might then be risking its assets on enterprises alien to the purposes for which it was formed. Northside Ry. v. Worthington, 88 Tex. 562, 568-69, 30 S.W. 1055, 1056 (1895). See, e.g., Rio Refrigeration Co. v. Thermal Supply of Harlingen, Inc., 368 S.W.2d 128 (Tex. Civ. App.—San Antonio 1963); Ingram v. Texas Christian Univ., 196 S.W. 608 (Tex. Civ. App.—Fort Worth 1917), error ref. See generally W. FLETCHER, CYCLOPEDIA CORPORATIONS § 2588; 1 I. HILDEBRAND, TEXAS CORPORATIONS § 76.


109. Other obvious advantages attainable through use of guaranties are assuring sources of supplies and components, aiding franchise operations of franchisees, and assitting subsidiary corporations in their operations. Generally, guaranties for the benefit of subsidiaries are sustained on the basis of the direct benefit derived in protecting the parent's investment in such entities. See, e.g., Baker v. Edson Hotel Operating Co., 99 S.W.2d 998 (Tex. Civ. App.—Beaumont 1936); Ingram v. Texas Christian Univ., 196 S.W. 608 (Tex. Civ. App.—Fort Worth 1917), error ref. For a good summary discussion of the economic benefits that can be gained from guaranties, see Comment, The Guaranty: A Dilemma For Corporate Managers, 23 SW. L.J. 872 (1969).

110. TEX. BUS. CORP. ACT ANN. arts. 2.01(A) (1956); see text accompanying notes 82-89 supra.

111. TEX. ATT'Y GEN. OP. NO. WW-440 (1958).

112. TEX. BUS. CORP. ACT ANN. arts. 2.01(B)(4)(d), 9.14(A) (1956).

113. Id. art. 2.02 (Supp. 1974).

114. At the time the TBCA was originally drafted, the 1950 version of the Model Business Corporation Act on which the TBCA was based did not include the guaranty power among those enumerated in § 4 of that Act. It was added as an amendment in 1957 to § 4(b), which parallels TBCA art. 4.02(A)(9), by inserting the phrase "and guarantees" following the introductory words: "To make contracts ... " 1 ABA Model BUS. CORP. ACT ANN. 104 (1960). Article 2.02(A), as first enacted, closely followed § 4 of the Model Act as it then read. Comment of Bar Committee to Art. 2.02, 3A TEX. REV. CIV. STAT. ANN. 24 (1956). Thus, in simply following the Model Act pattern in omitting the guaranty power from that article the Bar Committee had no intention of precluding the exercise of the guaranty power by Texas corporations. Indeed it could be argued the power was inferred by other provisions of the article, e.g., arts. 2.02(A) (5), (7), (9), (10), and (20). See 19 R. HAMILTON, TEXAS BUSINESS ORGANIZATIONS § 360, at 399 n.50 (1973).
tion,\textsuperscript{115} prohibits the creation of any indebtedness whatever except for money paid, labor done, or property actually received, although recognizing the conclusiveness of the board's or shareholders' judgment as to the value of the consideration received for such indebtedness, in the absence of fraud.\textsuperscript{116} Thirdly, when the legislature did endeavor to specifically recognize the guaranty power by an amendment added to article 2.06 in 1963,\textsuperscript{117} the provision was so narrow in scope, being limited to guaranties among corporations in a one hundred percent stock ownership relation with each other,\textsuperscript{118} it was of little use to most corporations.\textsuperscript{119} And while the amendment took pains to say it was not intended to limit any power corporations not meeting its terms might otherwise have,\textsuperscript{120} this was of no great aid, other than dispelling any notion of exclusivity, because it meant the validity of the power would still have to be resolved by the largely silent statutory law or by unsatisfactory common law principles. Finally, there was (and still is) article 1349, one of the remnants of the old corporation law left unrepealed after adoption of the TMCLA,\textsuperscript{121} which prohibits a corporation from using its assets, directly

\textsuperscript{115} Tex. Const. art. XII, § 6.

\textsuperscript{116} Tex. Rev. Civ. Stat. Ann. art. 1302-2.06(A) (1962). The statute does not precisely track its constitutional source. Thus both "labor done" and "property actually received" as proper consideration for creation of indebtedness are qualified by the phrase, "which is reasonably worth at the least the sum at which it is taken by the corporation," a phrase not found in the constitution. Nor does the latter provide for the "in absence of fraud" determination of the value of such consideration, a standard derived from Tex. Bus. Corp. Act. Ann. art. 2.16(C) (1956).


\textsuperscript{118} The 1963 amendment (which was not Bar Committee-sponsored), empowered a corporation doing business in the state to enter into written contracts of guaranty or to become liable on, or to mortgage, pledge, or make itself or its assets responsible for the lawful indebtedness of parent, subsidiary, or affiliated corporation, as those terms were defined in the section. As defined, the relationship between the guarantor and debtor corporations had to be based on a parent's ownership of 100% of the outstanding stock of its subsidiaries. A guarantor that ended up paying any of the indebtedness because of the up-stream, down-stream or cross-stream obligation was granted a cause of action to recover that amount, less any offset the other corporation might be entitled to. TMCLA art. 2.06(B), ch. 469, § 3, [1963] Tex. Laws 1184, as amended, Tex. Rev. Civ. Stat. Ann. art. 1302-2.06(B) (Supp. 1974).

\textsuperscript{119} For example, even a parent corporation owning as much as 90% of a subsidiary's outstanding stock that desired to guarantee the latter's obligations was forced to rely on the more general provisions of TMCLA art. 2.06(A) or on case precedents (see authorities cited in note 109 supra), even though it had sufficient ownership to effect a short form merger under Tex. Bus. Corp. Act Ann. art. 5.16 (Supp. 1974). For critical comments on the limited applicability of TMCLA art. 2.06(B), see 19 R. Hamilton, Texas Business Organizations § 360, at 400; Drury, Amendments to Corporations Laws, 33 Tex. B.J. 961 (1970); With, Corporate Guaranties: The Quest for Legislative Clarification, 36 Tex. B.J. 907 (1973).


\textsuperscript{121} When first enacted in 1955, the TBCA was applicable only to corporations formed or seeking to transact business in Texas after its effective date and to domestic and qualified foreign corporations adopting the Act, Tex. Bus. Corp. Act Ann. art. 9.14(D) (1956). Virtually none of the old corporation statutes found in title 32 of the Texas Revised Civil Statutes were repealed. Instead a period of 5 years was prescribed before the Act applied to all corporations, id. art. 9.14(E), and in the interim other pre-TBCA business corporations continued to be governed by the unrepealed laws. Id. art. 9.14(D); see Comment of Bar Committee to Art. 9.14, 3A Tex. Rev. Civ. Stat. Ann. 422 (1956). After the Act became applicable to all corporations in September 1960, the Bar Committee proposed a repeal of all the old laws that conflicted with the TBCA and with the Texas Non-Profit Corporation Act, passed under its sponsorship in 1959. Tex. Rev. Civ. Stat. Ann. arts. 1396-1.01 to -11.01 (1963), adopted by ch. 162, [1959] Tex. Laws 286. At one time, the committee proposed enactment of a Texas Corporation Code that would have included the TBCA, the Non-Profit Act, statutes dealing with spe-
or indirectly, to accomplish other than the legitimate business of its creation, on penalty of forfeiting its charter, that has been invoked at times as a ground for invalidating a corporate guaranty.

On the other hand, some relief has been afforded through judicial application of article 2.04 of the TBCA to prevent the corporation, at least, from avoiding liability on its guaranty by asserting its ultra vires nature or claim—

cial types of corporations, and miscellaneous provisions applicable to all corporations. Amsler, Report of Committee on Revision of Corporation Laws, 23 Tex. B.J. 327 (1960), but decided instead to seek passage of legislation that would recodify the general provisions of the old law worth retaining into a Texas Miscellaneous Corporation Laws Act, leave the statutes pertaining to special types of corporations untouched, and repeal the rest. Amsler, Proposed Corporation Law Revisions, 23 Tex. B.J. 709 (1960). Its proposals were all enacted, except that the legislature chose to exclude a few of the old statutes from the general repealer, ch. 229, § 1, [1961] Tex. Laws 458, mainly because those laws provided a further basis for state action to forfeit a corporation's charter or permit to do business in ultra vires acts or creating watered stock or indebtedness or to force cancellation of watered securities. See 19 R. HAMILTON, TEXAS BUSINESS ORGANIZATIONS § 1, at 7. Interestingly, article 1348, which prohibited creation of indebtedness except for receipt of the constitutionally prescribed consideration, see note 116 supra, was retained even though it had been substantially recodified in TMCLA art. 2.06; it was repealed in 1965 as the section B was added to that article to permit the 100% ownership intercorporate guaranties (with the former provision becoming section A) at the suggestion of this author to the amendment's legislative sponsor. Ch. 469, § 1, [1963] Tex. Laws 1184. However, TEX. REV. CIV. STAT. ANN. art. 1351 (1963), continues to provide that a violation of article 1348 or article 1349 (prohibiting ultra vires business) will furnish grounds for forfeiture of a corporation's charter or permit to do business in Texas. Arguably any violation of TMCLA art. 2.06(A), because of its derivation from article 1348, would be subject to the same sanction.

122. TEX. REV. CIV. STAT. ANN. art. 1349 (1962). Despite its sweeping terms, the statute has been repeatedly interpreted as being no more than a declaration of the common law principle confining a corporation's activities to the purposes for which it was formed with the consequence that an act violative of its provisions is not illegal, but ultra vires only. See, e.g., Continental Assurance Co. v. Supreme Constr. Corp., 375 F.2d 378 (5th Cir. 1967); Whitten v. Republic Nat'l Bank, 397 S.W.2d 415 (Tex. 1965); Staacke v. Routledge, 111 Tex. 489, 241 S.W. 994 (1922); Bond v. Terrell Cotton & Mfg. Co., 82 Tex. 309, 18 S.W. 691 (1891); I. HILDEBRAND, TEXAS CORPORATIONS 189. It is also to be interpreted so as not to nullify or conflict with article 2.04 of the TBCA. Republic Nat'l Bank v. Whitten, 383 S.W.2d 207 (Tex. Civ. App.—Dallas 1964), aff'd on other grounds, 397 S.W.2d 415 (Tex. 1965).

123. TEX. REV. CIV. STAT. ANN. art. 1351 (1962).

124. E.g., East Texas Motor Freight Lines v. Pollock Paper & Box Co., 197 S.W.2d 883 (Tex. Civ. App.—Dallas 1946), rev'd on other grounds, 145 Tex. 634, 201 S.W.2d 228 (1947); Newton v. Houston Hot Well Improvement Co., 211 S.W. 960 (Tex. Civ. App.—Beaumont 1919) (dictum); Carla Land & Irrigation Co. v. Asherton State Bank, 164 Tex. 394, 342 S.W. 228 (1931); Whitten v. Republic Nat'l Bank, 397 S.W.2d 415 (Tex. Civ. App.—Houston [14th Dist.] 1967), rev'd on other grounds, 436 S.W.2d 889 (Tex. 1969), discussed in Amsler, Corporations, Annual Survey of Texas Law, 23 Sw. L.J. 98, 103 (1969), in which the court rejected an argument that a family-owned corporation's guaranty of performance of contracts of another corporation controlled by the same family was illegal and void because it contravened articles 1349 and 1302-2.06(A). The court held that at most the guaranty was ultra vires, a defense the corporation could not assert under TBCA art. 2.04(B). The supreme court reversed and remanded because of improper admission of documentary evidence to prove the guaranteed indebtedness. Upon retrial, the plaintiff again recovered on the guaranty and his judgment was affirmed by the Houston first court of civil appeals in an unreported opinion that once more rejected the argument of illegality based on violation of the two statutes. An application for writ of error was refused for no reversible error. Witt, supra note 119; see Fagan v. LaGloria Oil & Gas Co., 494 S.W.2d 624 (Tex. Civ. App.—Houston [14th Dist.] 1973), a sequel to this protracted litigation.

ing its illegality under article 1349. But even the benefit of these decisions has been offset somewhat by the holding in *Inter-Continental Corp. v. Moody* permitting a shareholder to intervene in a proceeding between the corporation and the third party to prevent enforcement of an obligation claimed to be ultra vires. It is of no wonder then that Texas commentators, in lamenting the unresolved state of the law, asked for legislative reform.

Hopefully the call for reform has been answered by a Bar Committee sponsored amendment of TMCLA article 2.06(B) that endeavors to cut the Gordian knot of uncertainty and spell out for once and for all the corporate guaranty power in Texas. Under the amendment, either a domestic or qualified foreign corporation is empowered to make a guaranty of contracts, securities or other obligations of another individual or entity if the guaranty "may reasonably be expected to benefit, directly or indirectly, the guarantor corporation." However, in keeping with the prohibition on lending money to officers or directors, guaranties cannot be made for those officials. The

126. Cooper Petroleum Corp. v. LaGloria Oil & Gas Co., 423 S.W.2d 645 (Tex. Civ. App.—Houston [14th Dist.] 1967), rev'd on other grounds, 436 S.W.2d 889 (Tex. 1969); see notes 122, 124 supra.


128. The defendant corporation had been sued on a note which it claimed had been executed solely to compensate a lender for making a personal loan to its controlling shareholder and from which it received no benefit. Apparently the intervention was successful because on retrial the corporation's liability was confined to the proportion of the benefit it was shown to have derived from the primary loan, but not for the balance. Witt, supra note 119, at 911-12.


131. Ch. 285, § 1, [1973] Tex. Laws 676, amending Tex. Rev. Civ. Stat. Ann. art. 1302-2.06(B) (Supp. 1974). Adoption of the amendment culminated a long and sometimes frustrating effort by the Bar Committee to revise the statute and clarify the law on corporate guaranties. In 1967 the Committee drafted a bill to reduce the 100% stock ownership required for intercorporate guaranties to 50%, but it was withdrawn after running into objections by the State Bar Legislative Liaison Committee questioning its constitutionality under article XII, § 6 of the Texas Constitution. Comment, supra note 130, at 882 n.88. The committee came back with a revised version in 1971 that expanded the guaranty power to encompass any guaranty that could be expected to benefit, directly or indirectly, the guarantor corporation. See Drury, supra note 130, at 962; Lebowitz, Corporations, Annual Survey of Texas Law, 26 Sw. L.J. 86 n.7 (1972). Undaunted, the committee returned a third time with an expanded version of the 1971 bill and finally attained success. See Kerr, Proposed Amendments to Corporation Laws, 35 Tex. B.J. 1133, 1134 (1972); Witt, supra note 119, at 912.


133. Tex. Bus. Corp. Act Ann. arts. 2.02(A)(6), 2.41(A)(4) (1956). Consistent with the approach taken by the courts to ultra vires guaranties, these statutes are regarded as limitations on the exercise of the corporate power to lend, not proscriptions of illegal acts; hence a loan to an officer or director will be regarded as no more than an ultra vires act. See Whitten v. Republic Nat'l Bank, 397 S.W.2d 415 (Tex. 1965),
decision of the board of directors concerning the presence of the benefit, whether direct or indirect, the corporation may reasonably expect to gain thereby is binding upon it unless the party seeking to enforce the guaranty induced its making by fraud on the guarantor corporation or else had notice of such fraud before he acquired his rights under the guaranty. If the guaranty has not yet been made, a shareholder acting in his representative capacity can seek to enjoin its making if he can show no reasonable expectation of direct or indirect benefit to the corporation. But once the guaranty has been entered into, the corporation is bound thereby and it is doubtful that even shareholder intervention as in Inter-Continental can avoid its liability thereon.\textsuperscript{134} Presumably any authorization of the making of the guaranty by the board implies a decision on its part that the guaranty will be of benefit to the corporation, but in view of the statutory language\textsuperscript{135} it would be wise to have the guaranty recite the board’s decision as to such benefit.

Although, in the absence of fraud, the corporation must honor the guaranty once it has been made, there still may be recourse against the directors who approved or assented to its making if no reasonable expectation of benefit can be shown to have existed.\textsuperscript{136} The action can be brought by the corporation or its legal representative or by a shareholder in a representative action, seeking damages or other relief. The directors are entitled to assert any defenses they have under “any other laws of the State of Texas.”\textsuperscript{137} The quoted phrase undoubtedly covers the defense of reliance in good faith and in the exercise of ordinary care on a written opinion of an attorney for the corporation, set out in TBCA article 2.41(D); presumably it would also encompass the safe harbor sometimes afforded by the general business judgment rule\textsuperscript{138} or other affirmative defenses.\textsuperscript{139}

\textit{discussed in Pelletier, Corporations, Annual Survey of Texas Law, 21 Sw. L.J. 134, 150 (1967), noted in 20 Sw. L.J. 861 (1966); 19 R. HAMILTON, TEXAS BUSINESS ORGANIZATIONS § 361.}

\textsuperscript{134} A shareholder is given standing to enjoin the making of a guaranty not reasonably expected to benefit the corporation, but such action must be brought “prior to the making of a guaranty by a corporation.” TMCLA art. 2.06(B), TEX. REV. CIV. STAT. ANN. art. 1302-2.06(B) (Supp. 1974). In contrast, the comparable provision in the TBCA, relied on in the \textit{Inter-Continental} case, permits an action by a shareholder to enjoin the doing of an ultra vires act or the ultra vires transfer of any real or personal property and the requested relief may be granted if the unauthorized act or transfer “is being, or is to be, performed.” TEX. BUS. CORP. ACT ANN. art. 2.04(B)(1) (1956). Since litigation involving a guaranty is not likely to occur until the corporation is called upon to carry out its obligation, a shareholder would normally have sufficient time to bring an original injunctive proceeding, or intervene as permitted in \textit{Inter-Continental}, under article 2.04(B), were it not for the more explicit language in TMCLA art. 2.06 (B). The latter statute reinforces the need for prompt shareholder action before the guaranty is made by providing that once it has been entered into, the only recourse the shareholder then has is to bring a derivative or representative action against the directors responsible therefor for damages or other relief.

\textsuperscript{135} “\textit{The decision of the Board of Directors} that the guaranty may reasonably be expected to benefit, directly or indirectly, the guarantor corporation shall be binding upon the guarantor corporation . . . .” TMCLA art. 2.06(B), TEX. REV. CIV. STAT. ANN. art. 1302-2.06(B) (Supp. 1974) (emphasis added).

\textsuperscript{136} Id.

\textsuperscript{137} Id.

\textsuperscript{138} In essence, this rule exonerates directors or officers from liability for honest mistakes and errors in judgment that may cause economic or other harm to the corporation if they have acted in good faith, for the best interests of the corporation, and without violation of their duties of care and loyalty. It is also used at times to justify judicial refusal to interfere with management’s business decisions on the ground that a court
The amendment reiterates the former language that the section is not intended to limit or deny any other power the corporation is permitted to exercise under the law but adds a proviso that the section is not to apply to or enlarge the powers of any corporation subject to regulation under the Texas Insurance Code nor permits any corporation not subject to such regulation to engage in any character, type, class, or kind of fidelity, surety or guaranty business or transaction subject to regulation under the Insurance Code. In one regard, however, the amendment might seem to be more restrictive than the former provision. Insofar as the latter sanctioned a guaranty of the indebtedness of any parent, subsidiary, or affiliate of the guarantor corporation, the amendment explicitly encompasses such entities within its terms. Yet the old section spoke not only of guaranteeing such indebtedness, but also of becoming liable thereon and "to mortgage, pledge or make itself or its assets responsible" therefor. Although these words are not contained in the amendment, the general power to secure obligations by mortgage or pledge is already conferred by the TBCA and the power to guarantee not to substitute its own judgment as to the wisdom of such decisions if the directors seem to be acting properly in their determination. Invocation of the rule by a court frequently signals a decision not to find the directors or officers liable for the questioned transaction. See, e.g., Cates v. Sparkman, 73 Tex. 619, 11 S.W. 846 (1889); Bounds v. Stephenson, 187 S.W. 1031 (Tex. Civ. App.—Dallas 1916), error ref.; Farwell v. Babcock, 27 Tex. Civ. App. 162, 65 S.W. 509 (1901). See generally 20 R. HAMILTON, TEXAS BUSINESS ORGANIZATIONS § 720; HENN 482; Lebowitz, Director Misconduct and Shareholder Ratification, 6 BAYLOR L. REV. 1, 14-15 (1953); Lewis, The Business Judgment Rule and Corporate Directors’ Liability for Mismanagement, 22 BAYLOR L. REV. 157 (1970); Note, The Continuing Viability of the Business Judgment Rule as a Guide for Judicial Restraint, 35 GEO. WASH. L. REV. 562 (1967); Note, The Business Judgment Rule: A Guide to Corporate Directors’ Liability, 7 ST. LOUIS U.L.J. 151 (1962).
anty now expressly conferred undoubtedly implies a power to mortgage or pledge assets for another corporation's benefit.\textsuperscript{146}

\textbf{Criminal Liability.} In a sense, the most revolutionary change in the Texas law of corporations was not made by amendments to the TBCA and TMCLA but resulted from the complete revision of the Texas Penal Code and conforming amendments to the Code of Criminal Procedure and other laws which become effective on January 1, 1974.\textsuperscript{147} For years Texas stood alone as the only jurisdiction in which corporations bore no general criminal responsibility.\textsuperscript{148} While there were a few statutes that imposed criminal liability in limited situations, mainly for pollution or willful violations of economic regulatory legislation,\textsuperscript{149} even these were virtually negated by the absence of a procedure under which Texas corporations could be prosecuted.\textsuperscript{150} Under the new criminal legislation,\textsuperscript{151} all this has changed. Texas corporations have become both criminally responsible and prosecutable. So, for that matter, have all business or non-business associations.\textsuperscript{152}

\textsuperscript{146} Comment of Bar Committee to TMCLA art. 2.06, 3 TEX. REV. CIV. STAT. ANN. 132 (Supp. 1974); Doty & Parker 1027.
\textsuperscript{148} E.g., TEX. REV. CIV. STAT. ANN. art. 4477-5b, §§ 1(2), (4) (Supp. 1974) (air pollution); TEX. WATER CODE ANN. §§ 21.551-553 (1972) (water pollution); TEX. REV. CIV. STAT. ANN. art. 6008, §§ 2, 23 (1962) (regulation of natural gas production); \textit{id.} art. 4477-6, §§ 2(m), 19(a) (Supp. 1974) (Texas Renderers' License Act); various consumer protection statutes in \textit{id.} art. 5069: -1.01, -1.06 (1971) (usury), -2.01(a), -8.03 (1971) (lending without license), -11.01(g), -11.09 (Supp. 1974) (improper debt collection), -51.02(a), -51.17(a) (Supp. 1974) (operating pawnshops without license); and Tex. Bus. & COMM. CODE ANN. §§ 17.45(3), 17.62(a) (Supp. 1974) (deceptive trade practices).
\textsuperscript{150} The provisions relating to criminal responsibility of corporations and associations were derived from \textit{MODEL PENAL CODE} §§ 2.07, 6.04 (Proposed Official Draft 1962) and were based on a study and recommendations by Professor Hamilton who served as reporter to the Texas Penal Code revision project on the subject. Hamilton, supra note 148, at 76.
\textsuperscript{152} Prior to the 1973 revision there was considerable doubt whether a partnership, firm, or an unincorporated association of any type could be prosecuted for a crime. Several cases indicated by way of dicta they could not be. Overt v. State, 97 Tex. Crim. 202, 209, 260 S.W. 856, 859 (1924); Judge Lynch Int'l Book & Pub. Co. v. State, 84 Tex. Crim. 459, 208 S.W. 526 (1919); Petersen & Fitch v. State, 32 Tex. 477 (1870); cf. Mills v. State, 23 Tex. Crim. 295, 301 (1859) (partnership not a company or association of individuals within penal statute against illegal banking). See 19 R. HAMILTON, TEXAS BUSINESS ORGANIZATIONS § 154, at 147; 44 TEX. JUR. 2d, \textit{Partnership} § 94, at 421 (1963). Moreover, a 1969 attorney general's opinion ruled that it would be unconstitutional to make associations, partnerships, firms, trusts, and estates subject to criminal sanctions for air or water pollution and under specific procedures applicable to corporations and other entities for such acts, as provided in two bills then pending in the 61st Legislature, although corporations could properly be brought within the provisions of the proposed statutes. Tex. ATTY. GEN. Op. No. M-348, at 1723 (1969). As a consequence, the two statutes when enacted confined their definitions of "person" to individu-
The revised criminal statutes deal with corporations and associations in several ways. First, the term “person” is defined in both Codes\textsuperscript{153} to include a corporation or association. The latter in turn is defined to include a trust, partnership, or two or more persons having a joint or common economic interest.\textsuperscript{154} To describe the corporate or associational representatives whose acts can give rise to criminal liability, “agent” is used to mean a director, officer, employee or other authorized representative,\textsuperscript{155} and “high managerial agent” to designate a partner in a partnership, an officer in a corporation, or association, or an agent of either whose duties and responsibilities are such that it may be assumed his conduct represents the organization’s policy.\textsuperscript{156}

A specific subsection sets out the substantive bases for the criminal responsibility of corporations and associations and those who act in their behalf and at the same time creates a due diligence defense against some prosecutions.\textsuperscript{157} Since a corporation can only carry on its business through its representatives, responsibility is assessed in terms of who performs the criminal act. If committed by an agent who acts in the corporation’s behalf and within the scope of his office or employment, the corporation can be found guilty if the offense is one defined in the code or in another statute where it is clear the legislature intends to impose corporate criminal responsibility or else create strict liability without regard to culpable mental state, unless the contrary intent appears.\textsuperscript{158}

Whether the agent is acting within the scope of his duties is an issue that should be resolved on the basis of general agency principles.\textsuperscript{159}
The requisite that he act in behalf of the corporation refers to the capacity in which he performs the act and not his motivation which may be for his own personal benefit and indeed may harm the corporation. On the other hand, responsibility for a felony offense is limited to cases where its commission was either initiated, performed, or recklessly tolerated by a majority of the board acting in their capacity as such or by a high managerial agent acting for the corporation and in the scope of his office or employment. Given these limits, there are not likely to be many felony prosecutions. In addition, the corporation or association may assert as an affirmative defense that the high managerial agent who had supervisory responsibility over the subject matter of the offense used due diligence to prevent its being committed. Even so, the defense cannot be used if it would be inconsistent with the law defining the particular offense, or if the prosecution is under a non-Code statute imposing strict liability for its violation or is for a felony offense.


The defense is limited to prosecutions under § 7.22(a)(1) or (a)(2). It would obviously be inconsistent with a statute imposing strict criminal liability. As to felony offenses, as set out in § 7.22(b), the defense is precluded because if a majority of the board or a high managerial agent is involved, the corporation should be bound even if other directors or high managerial agents exercise due diligence. Committee Comment to § 7.24, Proposed Texas Penal Code (1970).
Even though the corporation may be found guilty of a criminal act, the person committing the crime is not exonerated. If he acted in the corporation's name or behalf or if he fails to discharge a duty imposed on the corporation by law for which he has primary responsibility, he is as culpable as if he acted for himself or the duty were imposed on him, and is subject to the same penalty any individual convicted of the offense would receive.\(^{166}\)

Since obviously a corporation cannot be imprisoned or executed, the sanction for committing a crime must either be in the nature of a fine or penalty or else termination of the corporation's existence in the state by forfeiting its charter or, if a foreign corporation, cancelling its permit to do business. The revision provides both. If an offense is punishable by a fine only, then it is the sanction imposed; if imprisonment is part of the punishment or if no penalty is prescribed for an offense, the court may substitute a fine, the amount of which, depending on the gravity of the offense, may range from $200 to $10,000,\(^{167}\) or as an alternative, if the offense is one from which the corporation gained some material benefit, such as obtaining property or credit by a false statement\(^{168}\) or deceptive business practices,\(^{169}\) the court may fine the corporation an amount up to double the economic gain, unless the offense was a class C misdemeanor.\(^{170}\) Unlike individuals, the corporation or association is not eligible for probation.\(^{171}\) In addition to the fine imposed, the court is obligated to notify the attorney general of a corporation's conviction or that of a high managerial agent with regard to an offense committed while conducting the corporation's affairs.\(^{172}\) The attorney general in turn may seek involuntary dissolution or revocation of a certificate of authority to transact business in Texas if the offense committed by either the corporation or the high managerial agent was a felony.\(^{173}\) However, to gain this ultimate sanction the court must be shown both that the corporation or the high managerial agent acting in its behalf has engaged in a persistent course of felonious conduct and that dissolution or revocation is required to prevent future conduct of the same character.\(^{174}\) In view of the limited basis

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\(^{166}\) Tex. Pen. Code Ann. § 7.23 (Supp. 1974). Thus, either the corporation or the agent or both can be prosecuted. Committee Comment to § 7.25, Proposed Texas Penal Code (1970). See also discussion in text accompanying notes 830-37 infra. The rule is, of course, the same for civil liability. See, e.g., A.H. Belo & Co. v. Fuller, 84 Tex. 450, 452, 19 S.W. 616, 617 (1892) (dictum) (libel); Penroc Oil Corp. v. Donahue, 476 S.W.2d 849, 851 (Tex. Civ. App.—El Paso 1972), error ref. n.r.e. (fraud), discussed in Lebowitz, Corporations, Annual Survey of Texas Law, 27 Sw. L.J. 85, 93 (1973); Sutton v. Reagan & Gee, 405 S.W.2d 828, 833 (Tex. Civ. App.—San Antonio 1966), error ref. n.r.e., discussed in Pelletier, supra note 133, at 144.

\(^{167}\) Tex. Pen. Code Ann. §§ 12.51(a), (b) (Supp. 1974). The maximum fine for a felony is $10,000; for a class A or class B misdemeanor, $2,000; for a class C misdemeanor, $200.


\(^{169}\) Id. § 32.42.

\(^{170}\) Id. § 12.51(c).


\(^{173}\) Tex. Bus. Corp. Act Ann. arts. 7.01(F), 8.16(F) (Supp. 1974).

\(^{174}\) Id. arts. 7.01(F)(1), (2), 8.16(F)(1), (2).
on which involuntary dissolution or revocation can be obtained, it is not clear why the attorney general must be notified of misdemeanor convictions unless to alert him to a potential corporate wrongdoer whose activities might provide some other basis for action by the state.\textsuperscript{175}

Finally, to deal with the hiatus in the law that precluded prosecution of corporations except in very limited circumstances,\textsuperscript{176} a new chapter has been added to the Code of Criminal Procedure that sets out some of the procedural rules applicable to crimes of corporations and associations.\textsuperscript{177} These deal primarily with the method of alleging the corporation's name,\textsuperscript{178} the use of a summons as the means of notification that a complaint has been filed or an indictment or information presented against it,\textsuperscript{179} and the mode of service of the summons,\textsuperscript{180} and the manner a corporation appears\textsuperscript{181} or manifests its presence in the prosecution against it.\textsuperscript{182} The rules are not exclusive; other provisions of the Code of Criminal Procedure apply if not inconsistent.\textsuperscript{183}

Thus, Texas has finally rejoined the ranks on corporate criminal responsibility. Perhaps now Dean Prosser's famous lyric that "Texas has, of all states, the most peculiar law"\textsuperscript{184} has become outdated—at least as to this aspect of the law.

II. Control and Management of Corporations

A. Shareholder Action

Shareholders' Meetings. Several changes have been made in TBCA article 2.24 relating to shareholders' meetings.\textsuperscript{185} The most important is one designed to provide a greater flexibility in determining where and when meetings are to be held. Previously, all meetings had to take place at the locale, and the annual meeting at the time specified in the bylaws,\textsuperscript{186} unless the bylaws were silent on the matter.\textsuperscript{187} Now other methods for fixing

\textsuperscript{175} E.g., involuntary dissolution under \textsc{Tex. Bus. Corp. Act Ann.} art. 7.01 (1956), forfeiture of charter under \textsc{Tex. Const.} art. IV, § 22 and \textsc{Tex. Rev. Civ. Stat. Ann.} art. 4408 (1960), or by quo warranto proceedings under id. art. 6253 (1962); see 20 R. HAMILTON, \textsc{Texas Business Organizations} § 937.

\textsuperscript{176} In 1969 the legislature adopted two statutes dealing with air and water pollution that also provided specific procedures by which corporate violators could be prosecuted. Ch. 153, § 1, [1969] Tex. Laws 480 (air pollution), codified as \textsc{Tex. Pen. Code} art. 698d, and ch. 154, § 1, [1969] Tex. Laws 483 (water pollution), codified as \textsc{Tex. Pen. Code} art. 698c. R. HAMILTON, \textsc{Texas Business Organizations} § 239, at 261; Hamilton, \textit{supra} note 150, at 93. For the subsequent legislative history and treatment of these statutes, see note 152 \textit{supra}.


\textsuperscript{178} \textsc{Tex. Code Crim. Proc. Ann.} art. 17A.02 (Supp. 1974).

\textsuperscript{179} \textit{id.} art. 17A.03.

\textsuperscript{180} \textit{id.} arts. 17A.04, 17A.05.

\textsuperscript{181} \textit{id.} art. 17A.06.

\textsuperscript{182} \textit{id.} art. 17A.07.

\textsuperscript{183} \textit{id.} art. 17A.01(a).

\textsuperscript{184} Prosser, \textit{The Common Law of Texas}, in \textsc{Law School Association Lyrics} 68 (undated pamphlet in University of Texas Law Library).


\textsuperscript{187} In that case meetings were to be held at the registered office of the corporation. There has been no change in this provision. \textit{id.}
time and place can be used if "in accordance with" the bylaws. For example, it may be wise to give the board of directors or the president discretionary power to call the annual meeting at varying locations, possibly as a means of improving shareholder relations, or to fix a more suitable time for the meeting if the usual date becomes inconvenient for some reason or another.

Another change simplifies a shareholder's course of action if the annual meeting is not held at the time designated in or fixed as permitted by the bylaws. Under the former law, if the board failed to call the meeting at the designated time, the shareholder had to demand it be held within a reasonable period and then, only if sixty days elapsed without his demand being satisfied, could he seek judicial redress to have the meeting held, he being specifically given a sufficient justiciable interest to institute such action.

Under the amendment, if the annual meeting is not held within any thirteen-month period, a shareholder may apply directly to a court of competent jurisdiction in the county where the principal office is located asking that it summarily order the meeting be held. Apparently the corporation and

188. TEX. BUS. CORP. ACT ANN. art. 2.24(A) (Supp. 1974).
189. For example, the corporation may be negotiating a merger which will require approval by the shareholders at a date quite near the time usually set for the annual meeting but which cannot be delayed until that time. Considerable expense could be avoided by having the power to advance the annual meeting date to coincide with the date on which the merger needs approval. The example is suggested in the helpful article by Kerr & Wolf, Shareholders' Meetings Under the Texas Business Corporation Act, 43 TEXAS L. REV. 713, 714 (1965).
190. Ch. 64, art. 2.24(B), [1955] Tex. Laws 239, as amended, TEX. BUS. CORP. ACT ANN. art. 2.24(B) (Supp. 1974).
191. "Each and every shareholder is hereby declared to have a justiciable interest sufficient to enable him to institute and prosecute such legal proceedings." Id. The 1973 amendment omits this sentence, mainly because the Bar Committee felt the proposition stated was so self-evident that its statutory formulation was superfluous. Even in the absence of statute, the courts have always recognized a shareholder's standing to seek judicial aid, primarily by mandamus, whenever there has been a wrongful refusal or negligent omission to hold the annual meeting. Otherwise "a board of directors by ignoring the demand of the by-laws for stated elections, could perpetuate themselves in office and rob stockholders of all voice in the affairs of the corporation." Bard v. Kapp, 15 S.W.2d 719, 720 (Tex. Civ. App.-San Antonio 1929), error ref. The Bard case is the only Texas decision in point and follows the general rule that courts have power to compel corporate officers to call meetings to elect directors. See generally 5 W. FLETCHER, CYCLOPEDIA CORPORATIONS § 2000; Annot., 48 A.L.R.2d 615 (1956).
192. Presumably this would be the district court on the assumption the order sought would be in the nature of a writ of mandamus, although conceivably the same result could be accomplished by a mandatory injunction. See 6 Z. CAVITCH, supra note 21, § 117.03(2), at 443; Annot., supra note 191, at 617. While the county court has power to grant mandamus, TEX. CONST. art. V, § 16; TEX. REV. CIV. STAT. ANN. art. 1957 (1964), its original jurisdiction to issue the writ is dependent on the requisite amount in controversy being in issue. Johnson v. Hanscom, 90 Tex. 321, 38 S.W. 761 (1897), if no amount in controversy is alleged, as would typically be the case where a shareholder seeks to compel the holding of a meeting to elect directors or inspect corporate records, then only the district court has jurisdiction. TEX. CONST. art. V, § 8; TEX. REV. CIV. STAT. ANN. arts. 1913, 1914 (1964). See, e.g., Anderson v. Ashe, 99 Tex. 447, 90 S.W. 872 (1906); Pounds v. Callahan, 337 S.W.2d 148 (Tex. Civ. App.—Beaumont 1960); City of Lubbock v. Green, 312 S.W.2d 279, 283 (Tex. Civ. App.—Amarillo 1958) (dictum); cf. Repka v. American Nat'l Ins. Co., 143 Tex. 542, 186 S.W.2d 977 (1945); Hood v. Cain, 32 S.W.2d 485 (Tex. Civ. App.—Amarillo 1930), error ref. See generally 6 L. LOWE, TEXAS PRACTICE—REMEDIES—INJUNCTIONS AND OTHER EXTRAORDINARY PROCEEDINGS §§ 332-33 (2d ed. 1973); A. MITCHELL & C. GILBERT, TEXAS METHODS OF PRACTICE §§ 3488-89 (1970); Comment, Courts—Jurisdiction of District and County Courts of Texas To Issue Injunction and Mandamus, 12 TEXAS L. REV. 437 (1934).
not the board is to be the defendant; whether individual officers need be joined may well depend on the nature of the order. Based on the amendment's apparent derivation from the Delaware practice, it would appear to give the court plenary power to directly order the meeting be held at a time and place and with such notice as may be prescribed in its order, without commanding the board or specific officers to do so. But if assumed to be in the nature of a writ of mandamus, the president, secretary, or other officer having the duty of calling the meeting might be made the defendant. In any event, failure to hold the meeting at the designated time continues to provide no basis for dissolving the corporation.


194. Most of the changes made in article 2.24 are taken from section 28 of the Model Act which, as revised in 1969, in addition to providing greater flexibility as to the manner of determining the time and place of shareholders' meetings, see text accompanying notes 186-89 supra, also added the summary order procedure to compel the holding of a passed meeting that had been part of the Delaware law for many years. Del. Code Ann., tit. 8, § 211(c) (Supp. 1968); E. Folk, The Delaware Corporation Law 206 (1972). Given the novelty of the procedure it would have been helpful to have added a sentence or two to the section as Delaware has done to spell out some of the matters that may be provided for in the court's order and, if necessary, to have a master appointed to conduct the election. Id. §§ 211(c), 227(b).

195. See e.g., Prickett v. American Steel & Pump Corp., 251 A.2d 576 (Del. Ch. 1969); In re Gulia, 13 Del. Ch. 1, 114 A. 596 (1921). See generally 6 Z. Cavitth, supra note 21, § 117.03(2), at 444.

196. Although as noted in the text accompanying note 195 supra, the summary order differs from mandamus in that the court may order the passed meeting called rather than direct an officer or the board to do so, it is likely the Texas courts, because of their familiarity with mandamus, will apply its other requisites to such orders, including the prohibition against granting mandamus in an ex parte hearing. Tex. R. Civ. P. 694. On the other hand, because of the derivation of the summary order procedure from the Delaware chancery practice, see note 194 supra, the action may well be equitable in nature and thus could be deemed to involve a type of injunctive relief that in some instances is obtainable through an ex parte temporary restraining order. Tex. R. Civ. P. 680. However, the showing of irreparable injury, loss or damage that permits a temporary restraining order to be issued without notice probably could not be made to justify ordering the election of directors on an ex parte basis. Still, the need for determining the legal or equitable nature of this summary remedy may well be academic since in Texas at least the issuance of mandamus is largely governed by equitable principles anyway, despite its origin as a common law writ. E.g., Callahan v. Giles, 137 Tex. 711, 715, 155 S.W.2d 793, 795 (1941); Schooler v. Tarrant County Medical Soc'y, 457 S.W.2d 644 (Tex. Civ. App.—Fort Worth 1970). Presumably it will not be necessary to show a demand on the board or some corporate official that the meeting be held was made, as article 2.24(B) required before its amendment, although this is frequently a requisite for the common law mandamus action. E.g., Bard v. Kapp, 15 S.W.2d 719, 720 (Tex. Civ. App.—San Antonio 1929), error ref.; see 6 Z. Cavitth, supra note 21, § 117.03(2), at 445; Annot., supra note 191, at 630. And in view of the policy expressed in the statute that the annual election should not be delayed beyond 13 months, there may be a more limited discretion that can be exercised in determining whether to order the meeting held or not. See E. Folk, supra note 194, at 206.

197. In Bard v. Kapp, 15 S.W.2d 719 (Tex. Civ. App.—San Antonio 1929), error ref., the pre-TBCA case in point, mandamus was sought against the president and secretary, the court specifically ruling the corporation was not a necessary party. See note 193 supra. In an analogous situation involving efforts by shareholders to inspect corporate books and records, mandamus has been invoked more frequently but with no consistency in the type of corporate defendants sued. See, e.g., Moore v. Rock Creek Oil Corp., 39 S.W.2d 815 (Tex. Comm'n App. 1933), recommendation adopted (corporation and apparently president and secretary mandamused); Texas Infra-Red Radiant Co. v. Erwin, 397 S.W.2d 491 (Tex. Civ. App.—Eastland 1965), error ref., n.r.e. (corporation); Grayburg Oil Co. v. Jarrett, 16 S.W.2d 319 (Tex. Civ. App.—El Paso 1929) (president and secretary).

In a somewhat belated recognition of technological developments, permission has been granted to shareholders (and directors and members of board-designated committees) to participate in or hold meetings by conference telephone or similar communications equipment that enable all the participants to hear one another. Participation in this manner constitutes presence at a meeting unless it is for purposes of objecting that the meeting has not been lawfully called or convened. The articles or bylaws may restrict the use of the procedure and in any event notice of the meeting must continue to be given as required or permitted by law, unless waived in writing before or after the meeting.

From a practical standpoint, it is obvious the conference telephone procedure will only be useful or economically feasible for small meetings. While this limited utility should not unduly hamper conducting board or committee meetings in this fashion, the only shareholders' meetings where the procedure
might conveniently be employed would almost of necessity be those of close corporations with very few shareholders. On the other hand, there appears no reason why a publicly-held corporation employing, say, closed circuit television to conduct simultaneous shareholders' meetings around the country should not be allowed to do so; arguably it would be in compliance with the statute so long as any shareholder desiring to speak could be heard (to say nothing of being seen) by those in attendance wherever the various meetings are being held. 205

**Voting of Shares: Legislative Changes.** Certainly among the more innovative of the 1973 amendments were several that added new dimensions to the manner in which shareholder voting can be arranged in the corporation, including further clarification of the cumulative voting right.

**Disproportionate Voting.** At one time at common law, a shareholder could cast no more than one vote at a shareholders' meeting no matter how many shares he held, *i.e.*, one man, one vote. 206 While this made sense for non-profit membership corporations, it made very little sense in the context of business corporations dependent on varying contributions of capital. As a consequence, either by legislation or judicial holdings, the rule became firmly established that each share would be entitled to a vote, *i.e.* one share, one vote. 207 Although Texas law prior to the adoption of the TBCA was silent on the matter as to general business corporations, Dean Hildebrand had no doubt they were governed by the general rule. 208 In 1955, the TBCA adopted the prevailing law by specifically providing that each outstanding share, regardless of class, was entitled to one vote except to the extent the voting rights of a class might be limited or denied by the articles of incorporation. 209 The language used, in contrast to statutes in other states establishing the one vote per share principle except as otherwise provided in the articles, 210 made it doubtful the corporation could grant any class more or less than one vote per share, 211 even though a class could be denied voting rights.

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205. To come under the statute, closed circuit television would have to be regarded as "communications equipment" "similar" to a conference telephone. See Tex. Bus. Corp. Act Ann. art. 9.10(C) (Supp. 1974). The ambiguity is undoubtedly due to the derivation of the statute from the more limited Delaware provision. See note 200 supra.

206. SA Z. CAVITCH, supra note 21, § 109.03(1); 5 W. FLETCHER, CYCLOPEDIA CORPORATIONS 205; 2 I. HILDEBRAND, TEXAS CORPORATIONS 477. The leading American case so holding is Taylor v. Griswold, 14 N.J.L. 222 (1834). But see Ratner, The Government of Business Corporations: Critical Reflections on the Rule of "One Share, One Vote," 56 COLUM. L. REV. 1 (1970), where Professor Ratner shows that historically the rule giving one vote per each member of a business corporation was not an absolute; rather some of the earliest English and American corporations permitted voting by shares or allowed large shareholders to have a limited number of multiple votes depending on the size of their investment. Id. at 3-9.

207. 5 W. FLETCHER, CYCLOPEDIA CORPORATIONS § 2045, at 206.

208. 2 I. HILDEBRAND, TEXAS CORPORATIONS 479.


211. See Seamans & Barger, Multiple Votes Per Share, 16 BUS. LAW. 400 (1961), discussing a ruling of the Pennsylvania Bureau of Corporations under that state's Business Corporation Law of 1933 that the only deviation from one vote per share is no vote per share and that limited voting rights, as used in the statute, mean that the right...
as to many corporate actions. A 1973 amendment, following the 1969 revision of the Model Act, has removed the doubt: a Texas business corporation may provide for multiple or fractional voting of its shares if its articles of incorporation so authorize. If this choice is made, then any shareholder action required by the Act, the articles, or bylaws to have the vote can only be curtailed as to certain issues, thereby precluding a Pennsylvania corporation from utilizing multiple voting.

212. *Tex. Bus. Corp. Act Ann.* art. 2.12(A) (1956). However, there are a number of matters which may require approval by a class vote whether or not the class is entitled to vote by the articles of incorporation; e.g., amendments to the articles affecting the rights of the class, id. art. 4.03(B) (Supp. 1974); sale of all the assets not in the ordinary course of business, id. art. 5.10(A)(3); merger and consolidation, id. art. 5.03(B); voluntary dissolution, id. art. 6.03(A)(3).


215. The amendment has restructured section A so as to first state the one share, one vote principle, then list as exceptions: (a) the extent the articles provide for more or less than one vote per share, or, to the extent permitted by the Act, limit or deny voting rights to one class of shares, (b) "as otherwise provided by this Act." The latter has reference to article 5.13 which disenfranchises a dissenting shareholder who has demanded payment for his shares pursuant to the right given in article 5.11 and the procedure set out in article 5.12. A specific reference to article 5.13 had been added to article 2.29(A) at the time the dissent statutes were amended in 1967 to tighten up the dissent process, ch. 545, §§ 6, 12-13, [1967] Tex. Laws 1719, 1721, 1723, [*see* Amsler, *supra* note 127, at 62, but was deleted by the 1973 amendment in favor of the more general language quoted.

216. *Tex. Bus. Corp. Act Ann.* art. 2.29(D) (Supp. 1974). Of course cumulative voting itself provides a form of multiple voting, but is limited in that it can only be used for the election of directors. *See* discussion in text accompanying notes 227-60 infra.


218. *Henn 367.* Equal treatment of all shares within a single class would seem to be mandated by article 2.12(A) except to the extent that varying rights can be given to different series of preferred or special classes, including the right to vote, as permitted by article 2.13. However, disproportionate voting can be provided for in a one-class situation through an agreement among all the shareholders of a close corporation (as defined in article 2.30-1(A)) that meets the requisites of article 2.30-2. Among the matters that may be provided for in such agreements are provisions that regulate the division of voting power. *Tex. Bus. Corp. Act Ann.* art. 2.30-2(A)(3) (Supp. 1974); *see* discussion in text accompanying notes 538-43 infra.
founder\textsuperscript{219} to keep control by retaining a class of stock having many votes per share even though most of the equity has been donated to family members whose stock ownership, alternatively, may have only a fractional vote per share. Larger corporations may want to use such voting for shares given in mergers or purchases of assets to avoid dilution of control or possibly in voluntary reorganization situations to mollify preferred shareholders if it becomes necessary to split or increase the common stock to facilitate financing.\textsuperscript{220}

Despite its apparent novelty in Texas law, many of the desired advantages afforded by disproportionate voting were attainable under the TBCA even before its amendment, mainly through classification of shares.\textsuperscript{221} Thus, it has always been possible under the Act to set up two classes of stock each having the same number of shares but issuable for different par values or if no par shares for varying consideration.\textsuperscript{222} For example, A, a shareholder whose principal contribution will be his entrepreneurial talents can be given 10,000 shares of class A stock having low or no par value; whereas B who is providing the venture capital may be issued all 10,000 shares of class B having a par value of $10 a share, so that under the one-share, one-vote principle, each has equal voting power.\textsuperscript{223} In addition, fractional shares were (and still are) given voting rights,\textsuperscript{224} although given the limited reasons for their issuance,\textsuperscript{225} they have been less useful for control purposes. Because the new provisions are much more straightforward, the thoughtful corporate planner should now give serious consideration to the flexibility disproportionate voting affords both in aiding the acquisition-minded big corporation and in molding the structure of the close corporation.\textsuperscript{226}

**Cumulative Voting.** The TBCA provisions on cumulative voting\textsuperscript{227} have been shortened, yet clarified by one of the 1973 amendments, while another has eliminated a device that has been used to avoid its effect.

The legislative history of cumulative voting in Texas is a checkered one that has been recounted elsewhere.\textsuperscript{228} In short, prior to 1955 the corporation

\begin{footnotes}
\footnotetext{219}{See 1 F. O'Neal, Close Corporations § 3.22, noting that in England it is not uncommon to have "founders'" shares giving their holders a large number of votes per share on particular issues.}
\footnotetext{220}{See Seams & Barger, supra note 211, at 400, using this example to show the need for multiple voting.}
\footnotetext{221}{Tex. Bus. Corp. Act Ann. art. 2.12(A) (1956).}
\footnotetext{222}{Id. arts. 2.12, 2.15.}
\footnotetext{223}{In general on classification of shares as a control or equalizing device, see 1 Hornstein § 153; 1 F. O'Neal, Corporate Organizations §§ 3.23-36; W. Painter, Closely Held Corporations 134.}
\footnotetext{225}{Such shares are usually generated by stock dividends and splits, reclassifications, and mergers where as a result of these transactions a shareholder may be entitled to receive more or less than an equal multiple of shares based on his holdings. ABA Model Bus. Corp. Act Ann. 2d, at 501. See generally Sobieski, Fractional Shares in Stock Dividends and Splits, 16 Bus. Law. 204 (1960); Waring, Fractional Shares Under Stock Dividend Declarations, 44 Harv. L. Rev. 404 (1931).}
\footnotetext{227}{Tex. Bus. Corp. Act Ann. art. 2.29(D) (Supp. 1974).}
\end{footnotes}
statutes made no mention of such voting,\textsuperscript{229} then with adoption of the TBCA in 1955 and until 1957, cumulative voting was permitted unless denied in the articles;\textsuperscript{230} from 1957 to 1964, the right had to be conferred by the articles,\textsuperscript{231} and from 1964 to the present, it is again permitted unless expressly prohibited by the articles.\textsuperscript{232} When the last change of substance was made in 1961,\textsuperscript{233} a special subsection was added prohibiting adoption of an amendment denying the right unless approved by a vote of the holders of two-thirds of the shares of each class entitled to vote thereon,\textsuperscript{234} even though the TBCA's general provisions on amendments would have authorized such an amendment by the same vote.\textsuperscript{235} Because of the duplicative nature of the subsection, it has been removed and the cumulative voting section renumbered.\textsuperscript{236}

The TBCA, along with some other state corporation laws,\textsuperscript{237} has always

\textsuperscript{229} 3 I. Hildebrand, Texas Corporations 482. However, Dean Hildebrand believed cumulative voting was permissible if provided for in the charter or bylaws. See Quillian v. Hebronville Util., Inc., 241 S.W.2d 225 (Tex. Civ. App.—San Antonio 1951), aff'd sub nom. Robertson v. State ex rel. Clements, 406 S.W.2d 90 (Tex. Civ. App.—Fort Worth 1966), error ref. n.r.e., where in ruling cumulative voting was not available to elect directors of state banks because of non-applicability of the TBCA to such banks and a specific provision in the Texas Banking Code for straight voting, Tex. Rev. Civ. Stat. Ann. art. 342-402 (1973), the court stated: "The right of cumulative voting for directors does not exist at common law. It must have been conferred, if at all, by an operative constitutional or statutory provision." 406 S.W.2d at 94.

\textsuperscript{230} Ch. 64, art. 2.29(D), [1955] Tex. Laws 239.

\textsuperscript{231} Ch. 54, § 4A, [1957] Tex. Laws 111, amending Tex. Bus. Corp. Act Ann. art. 2.29(D) (1956). As enacted, shareholders of corporations formed or adopting the TBCA before the effective date of the 1961 amendment retained the right to vote cumulatively unless expressly denied by the articles, whereas those of corporations formed or adopting the Act after the effective date were denied the right unless expressly authorized by the articles.

\textsuperscript{232} Ch. 393, § 1, [1961] Tex. Laws 893, amending Tex. Bus. Corp. Act Ann. art. 2.29(D) (Supp. 1960). For some inexplicable reason the change did not become effective until June 1, 1964; as a consequence a shareholder was denied the right to vote cumulatively in 1963 because his corporation's charter made no provision for such voting, it having become subject to the TBCA in 1961. Wilson v. Scruggs, 368 S.W.2d 891 (Tex. Civ. App.—Waco 1963), error ref. n.r.e. Unlike the 1957 amendment, the 1961 law did not state whether shareholders of corporations formed under, adopting, or becoming subject to the Act between May 23, 1957 (the effective date of the 1957 amendment) and June 1, 1964, had the cumulative voting right if the articles said nothing about it. The 1973 amendment is equally silent on the matter. The Bar Committee and this author believe shareholders of those corporations do have that right, construing the legislature's non-inclusion of a savings clause in 1961 as a conscious decision to confer the right unless denied. Comment of Bar Committee to Art. 2.29, 3A Tex. Rev. Civ. Stat. Ann. 71 (Supp. 1974); Lebowitz, supra note 228, at 1. Professor Hamilton, however, believes there still may be some possible controversy about the matter. 19 R. Hamilton, Texas Business Organizations § 491, at 517.


\textsuperscript{234} Ch. 393, § 1, [1961] Tex. Laws 893 (repealed 1973).

\textsuperscript{235} Tex. Bus. Corp. Act Ann. arts. 4.01, 4.02 (Supp. 1974), but note that because of the revision of article 9.09, see discussion in text accompanying notes 28-36 supra, an amendment denying cumulative voting can now be adopted by a majority vote if the articles of incorporation permit. Interestingly, a change in cumulative voting rights is not among the specific amendments listed in article 4.01(B) nor for which class voting is specifically required in article 4.03(B) except as it might affect the relative rights of a class as stated in subsection (B) (5).

\textsuperscript{236} Ch. 545, § 17, [1973] Tex. Laws 1495, amending Tex. Bus. Corp. Act Ann. art. 2.29(D) (Supp. 1972). Subsection (3) dealing with notice of intent to vote cumulatively has been renumbered as subsection (2).

\textsuperscript{237} Ch. 64, art. 2.29(D) (1956). As enacted, shareholders of corporations formed or adopting the TBCA before the effective date of the 1961 amendment retained the right to vote cumulatively unless expressly denied by the articles.
required that written notice be given by a shareholder that he intends to vote cumulatively on or before the day preceding the election in order to alert the other shareholders who may then want to reconsider their own mode of voting. Otherwise, majority shareholders could conceivably lose control if they voted straight and the minority shareholders voting cumulatively had a sizeable percentage of the shares being voted. 

If other shareholders decided to vote cumulatively, too, to counteract the minority group, they might be faced with a technical objection that they could not for want of proper notice. Thus, in an effort to further “prevent the possible unfair use of technical procedures to gain undue influence in corporate affairs,” a sentence had been added to the notice requirement that once any shareholder gives written notice of his intent to vote cumulatively all other shareholders may.

The cumulative voting right, which is almost always opposed by management of publicly-held corporations, but which is of considerable benefit in

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239. _R. Hamilton, Texas Business Organizations_ § 491, at 518; _Lattin_ 378; _Folk, supra_ note 12, at 919; _Lebowitz, supra_ note 228, at 2.

240. For example, assume that in a corporation with 1,000 shares outstanding, the majority group owns 60% and the minority 40%. There are 5 directors to be elected. If the minority faction cumulates, it will have 2,000 votes which if divided among three of its nominees will give each 666 2/3 votes to 600 for each of the majority’s 5 nominees if they vote straight. In a few older cases, control was shifted in this fashion and upheld by the courts, e.g., _Chicago Macaroni Mfg. Co. v. Boggiano_, 202 Ill. 312, 67 N.E. 17 (1903); _Tomlin v. Farmers & Merchants Bank_, 52 Mo. App. 430 (1893); _Schwartz v. State ex rel. Schwartz_, 61 Ohio St. 422, 56 N.E. 201 (1900); _Wright v. Commonwealth_, 109 Pa. St. 560, 1 A. 794 (1885); _Pierce v. Commonwealth_, 104 Pa. 150 (1883). _See generally C. Williams, Cumulative Voting for Directors_ 42 (1951); _Bowes & DeBow, Cumulative Voting at Elections of Directors of Corporations_, 21 Minn. L. Rev. 351, 362 (1937).

241. If the minority shareholder wanting to vote cumulatively waited until the very last hours of the day preceding the election to deliver his written notice to the secretary, there probably would not be enough time for the other shareholders to file their notice of intent to qualify for such voting. In such a case, forcing an adjournment of the meeting for lack of a quorum, if the majority refused to attend, or asking for a recess until the next day would have been the only recourse. In a few cases where a shareholder has announced his intent to vote cumulatively, the courts have allowed the majority time to recast their votes in the same manner to prevent losing control. _See e.g., State v. Ellison_, 106 S.C. 139, 90 S.E. 699 (1921); _State v. Dailey_, 23 Wash. 2d 25, 158 P.2d 330 (1945). Maine, North Carolina and South Carolina permit a recess of several hours to be called upon request or at the discretion of the presiding officer when an announcement has been made that a shareholder will vote cumulatively, in order to give the other shareholders time to determine how they will vote. _Me. Rev. Stat. Ann._ tit. 13A, § 622 (Supp. 1973) (reasonable time); _N.C. Gen. Stat. Ann._ § 55-67(c) (Supp. 1973) (one to four hours); _S.C. Code Ann._ art. 12-16.20(b) (Supp. 1973) (up to two hours). A provision of this sort would be desirable for the Texas act, because even though a day’s warning is given and the other shareholders become entitled to vote cumulatively without notice, see text accompanying note 243 infra, some shareholders may come to the meeting unaware they have the right and thus need time to consider the effect of their voting.


244. The arguments usually advanced by management against cumulative voting include (1) the fear a director elected by a minority faction will represent only his own constituency and not the shareholders as a whole, (2) the danger the board will divide into factions and not work harmoniously together, (3) the need for the board being part of the management, (4) the fear vital information will be leaked by unfriendly directors, and (5) the inability to attract qualified outsiders to serve as directors because of their unwillingness to become involved in intracorporate combat. _See Williams, Cumulative Voting_, 33 Harv. Bus. Rev., No. 3, 1955, at 108, 112. _See also Axley, The
close corporations,\textsuperscript{245} can be diluted in several ways\textsuperscript{246} if not expressly abolished by an amendment to the articles.\textsuperscript{247} One is through classification of directors\textsuperscript{248} so as to reduce the number of directors to be voted on each year and thereby reduce the total number of votes that can be cast cumulatively.\textsuperscript{249} Another is simply to reduce the number of directors\textsuperscript{250} which now

\textit{Case Against Cumulative Voting, 25 Wis. L. Rev. 278 (1950); Campbell, The Origin and Growth of Cumulative Voting for Directors, 10 Bus. Law., No. 3, 1955, at 3; Gibson, Should Cumulative Voting for Directors Be Mandatory—a Debate, Negative, 11 Bus. Law., No. 1, 1955, at 22; Sturdy, Mandatory Cumulative Voting: An Anachronism, 16 Bus. Law. 550 (1961). Professor Hornstein made a sample check of 204 public-issue corporations and found that only 54 were incorporated in states where cumulative voting is mandatory and that of the remaining 150 organized in states where such voting is permissible only 10 permitted cumulative voting. 1 Hornstein 449. There are of course a number of arguments to be made for such voting. These include (1) fairness, (2) need for minority representation, (3) diversity of viewpoint, and (4) to check majority's power of control. Williams, supra, at 111. See also Sobieski, In Support of Cumulative Voting, 15 Bus. Law. 316 (1960); Steadman, Should Cumulative Voting for Directors Be Mandatory—a Debate, Affirmative, 11 Bus. Law., No. 1, 1955, at 9; Young, The Case For Cumulative Voting, 25 Wis. L. Rev. 49 (1950). 245 There is some diversity of view as to the desirability of cumulative voting in close corporations. Both Professors O'Neal and Painter believe it useful as a way for a close corporation shareholder to gain representation on the board. 1 F. O'Neal, Close Corporations §§ 3.14, 3.58; W. Painter, Close Corporations 132; cf. Axley, supra note 244, at 284 (conceding the utility of cumulative voting in some close corporation situations); Ballard, Arrangements for Participation in Corporate Management, 25 Temp. L.Q. 131, 139 (1951). Professor Hornstein believes cumulative voting is rarely relied on in close corporation situations because it can be so easily circumvented, although acknowledging that if circumvention can be prevented, it does assure minority representation on the board. 1 Hornstein 184. Professor Hamilton takes a somewhat middle ground stating that while a substantial minority shareholder can use such voting to become a director, caution should be exercised in relying upon it because of the ways it can be evaded. 20 R. Hamilton, Texas Business Organizations § 694. See Scott, The Close Corporation in Contemporary Business, 13 Bus. Law. 741, 749 (1958) (mechanics of cumulative voting too cumbersome for close corporation). Sturdy, supra note 244, at 117, argued that cumulative voting is of little help to the minority in the close corporation and suggested, based on interviews with a number of California firms specializing in close corporation matters most of whom agreed, that a minority's best remedy is "divorce" based on the California procedure for involuntary dissolution on complaint of a shareholder owning a third or more of the corporation's stock that he is being persistently unfairly treated by the majority. Cal. Corp. Code Ann. §§ 4651(e), 4657-9 (West 1955). Cf. Tex. Bus. Corp. Act Ann. art. 2.30-5 (Supp. 1974), discussed in text accompanying notes 554-56 infra, and art. 7.05(A)(1)(c) (1956). On balance, cumulative voting does assure a shareholder with significant ownership in the close corporation representation on the board, but the right definitely must be jealously guarded by agreement, as to which one of the 1973 close corporation amendments, article 2.30-2, should prove quite helpful, but also by giving the shareholder a veto power through high quorum and voting requirements as permitted in articles 2.28, 2.35, and art. 7.05; see also 11 Bus. Law., No. 1, 1955, at 22; Sturdy, Mandatory Cumulative Voting: An Anachronism, 16 Bus. Law. 550 (1961). Professor Hornstein believes cumulative voting is rarely relied on in close corporation situations because it can be so easily circumvented, although acknowledging that if circumvention can be prevented, it does assure minority representation on the board. 1 Hornstein 184. Professor Hamilton takes a somewhat middle ground stating that while a substantial minority shareholder can use such voting to become a director, caution should be exercised in relying upon it because of the ways it can be evaded. 20 R. Hamilton, Texas Business Organizations § 694. See Scott, The Close Corporation in Contemporary Business, 13 Bus. Law. 741, 749 (1958). On balance, cumulative voting does assure a shareholder with significant ownership in the close corporation representation on the board, but the right definitely must be jealously guarded by agreement, as to which one of the 1973 close corporation amendments, article 2.30-2, should prove quite helpful, but also by giving the shareholder a veto power through high quorum and voting requirements as permitted in articles 2.28, 2.35, and 9.08 in order to prevent any undesired alteration in the right. See 1 F. O'Neal, Close Corporations § 3.58, at 75.

246. On methods of diluting the cumulative voting right, in general see 5A. Z. Cavitch, supra note 21, 810.04[2][c]; 19 R. Hamilton, Texas Business Organizations § 494; Henn 365; 1 Hornstein 450; Lattin 377; C. Williams, supra note 240, at 48-61; Williams, supra note 244, at 109; Comment, Cumulative Voting—Removal, Reduction and Classification of Corporate Boards, 22 U. Chi. L. Rev. 751 (1955).

247. 1 F. O'Neal, Close Corporations 74; see note 234 supra.

248. Tex. Bus. Corp. Act Ann. art. 2.33 (1956) (allowing board of directors consisting of nine or more members to be divided into two or three classes with staggered terms of two to three years).

249. There were a number of noted cases in the 1950s involving the validity of classification of directors because of its adverse effect on cumulative voting. The cases arose mainly in states making the right mandatory either by constitution or statute but with the corporation law permitting classification. Compare Wolfson v. Avery, 6 Ill. 2d 78, 126 N.E.2d 701 (1955), and State ex rel. Sypthers v. McCune, 143 W. Va. 315, 101 S.E.2d 871 (1957) (striking down classification statutes as impeaching on the constitutional right of cumulative voting), with Bohannan v. Corporation Comm'n, 82 Ariz. 299, 313 P.2d 379 (1957), and Janney v. Philadelphia Transp. Co., 387 Pa. 282, 128 A.2d
can be effected more easily by management in view of the power vested in
the board to amend the bylaws. A third is to remove any director elected
by the minority through cumulative voting in a special meeting called for that
purpose after his election, provided the articles or bylaws permit removal of
directors without cause. Since the decision to remove a director can only
be resolved by a straight vote, the majority would then prevail. This un-
derstood result can normally be dealt with in two ways by proper provisions
in the articles or bylaws, assuming the minority shareholders have sufficient
bargaining power at the time these documents are drafted or amended to in-
fluence their content. One way, obviously, is to permit removal only if good
cause can be shown or to prohibit removal entirely. The other is to provide
that any director elected by cumulative voting cannot be removed from office

76 (1956) (upholding classification statutes despite constitutional guaranty of cumula-
tive voting), and with Humphrey v. The Winous Co., 165 Ohio St. 45, 133 N.E.2d 780
(1956) (finding classification statute compatible with another statute conferring manda-
tory cumulative voting rights). See McDonough v. Copeland Refrigeration Corp., 277
statute although another Michigan statute prohibited reduction of the number of direc-
tors if it would adversely affect the cumulative voting right. The Wolfson, Janney, and
Winous cases were commented on extensively; see bibliography in 1 ABA MODEL BUS.
CORP. ACT ANN. 2d, at 702. In general on classification as a means of diluting cumulative
voting, see CARY 285; 5 W. FLETCHER, CYCLOPEDIA CORPORATIONS § 2048.2 (rev.
repl. 1967); 19 R. HAMILTON, TEXAS BUSINESS ORGANIZATIONS § 494; 1 HORNSTEIN § 353
at 450; Adkins, Corporate Democracy and Classified Directors, 11 BUS. LAW., No.
1, 1955, at 31; Leckemby, Classification of Directors and Its Effect Upon Cumulative
Voting in Corporate Elections, 56 DICK. L. REV. 330 (1952); Sell & Fuge, Impact of
Classified Corporate Directorates on the Constitutional Right of Cumulative Voting, 17
U. PITT. L. REV. 151 (1956); Stephan, Cumulative Voting and Classified Boards: Some
Reflections on Wolfson v. Avery, 51 NOTRE DAME L. 351 (1956); Comment, supra
note 246, at 754.

250. TEX. BUS. CORP. ACT ANN. art. 2.32 (Supp. 1974), permitting number of direc-
tors to be reduced by amendment of either the articles or bylaws. See, e.g., Bond v.
Atlantic Terra Cotta Co., 137 App. Div. 671, 122 N.Y.S. 425 (1910) (reduction upheld
although purpose to eliminate minority representation on board through cumulative vot-
ing); Stone v. Auslander, 28 Misc. 2d 384, 212 N.Y.S.2d 777 (Sup. Ct. 1961) (reduction
of number of directors of national bank upheld although National Banking Act, 12
U.S.C. § 61 (1970), required cumulative voting). A few states have statutes that do
not allow a reduction in the number of directors if the votes cast against the amendment
were sufficient to have elected a director cumulatively but would not be enough to have
elected one to the reduced board. MO. REV. STAT. ANN. § 351.090(3)(a) (1966); N.C.
GEN. STAT. ANN. § 55-25(b) (Supp. 1973); R.I. GEN. LAWS ANN. § 7-11-34 (Supp.
1973). See generally 5 W. FLETCHER, CYCLOPEDIA CORPORATIONS § 2048.3; 1 HORN-
STEIN 451; 1 F. O’NEAL, CLOSE CORPORATIONS § 3.58, at 75; W. PAINTER, CLOSELY
HELD CORPORATIONS 133; Comment, supra note 246, at 753.

251. TEX. BUS. CORP. ACT ANN. art. 2.23 (Supp. 1974); see discussion in text ac-
companying notes 61-68 supra.

252. 5 W. FLETCHER, CYCLOPEDIA CORPORATIONS § 2048.3 (rev. repl. 1967); 19 R.
ST. JOHN’S L. REV. 357 (1953), invalidating a bylaw permitting removal of a director
without cause after a cumulative voting provision was added to the charter. See statutes
cited in note 255 infra.

253. However, such removal might be contrary to an agreement among the share-
holders of a close corporation that the shareholder-director being removed was to be a
director during the term of the agreement. Cf. Katcher v. Oshman, 26 N.J. Super. 28,
97 A.2d 180 (Ch. 1953), enforcing an agreement that corporate action could only be
taken if approved by holders of 90% of the shares so as to override a bylaw permit-
ting removal of a director by a majority vote of the shareholders. See 1 F. O’NEAL,
CLOSE CORPORATIONS § 5.19.
if the votes cast against his removal would have been sufficient to have elected him if cumulatively voted at an election, unless the entire board is being removed.254 The latter alternative has now been codified in the TBCA so that in any case where cumulative voting is permitted and less than all directors are being removed, the shareholders who have elected a representative to sit on the board by cumulative voting may block his removal, if they choose.255 As worded,256 the amendment would seem to preclude removal even for cause if the minority that elected him objects, although it is not likely the minority would vote to retain a director who has been guilty of flagrant misconduct. But suppose the misbehaving director happens to be the minority shareholder who has elected himself to the board through cumulative voting of his own shares? Whether, in either case, the inherent power of shareholders to remove for cause257 would then prevail remains an open question.258 It should also be noted that the new provision does not protect the cumulative voting right against dilution through classification of directors259 or reduction of their number.260 These must still be guarded against by agreement or through use of veto powers.

Voting Among Series of Shares. Very often preferred or special classes of shares can be issued in series if authorized by the articles of incorpora-

254. See 2 F. O'Neal, CLOSE CORPORATIONS § 10.26 for the text of a charter clause so providing.


256. "In the case of a corporation having cumulative voting, if less than the entire board is to be removed, no one of the directors may be removed if the votes cast against his removal would be sufficient to elect him if then cumulatively voted at an election of the class of directors of which he is a part." Tex. Bus. Corp. Act Ann. art. 2.32 (Supp. 1974). The language is taken directly from the Model Act, ABA MODEL BUS. CORP. ACT ANN. 2d, § 39.


258. See Campbell v. Loew's Inc., 36 Del. Ch. 563, 573, 134 A.2d 852, 858 (1957), holding shareholders have an inherent right to remove a director for cause even though he had been elected by minority shareholders through cumulative voting, for "otherwise a director who is guilty of the worst violation of his duty could nevertheless remain on the board." Id. at 572, 134 A.2d at 858. But note that Delaware does not have a statute dealing expressly with removal of directors. E. Folk, supra note 194, at 57.

259. See notes 248-49 supra.

260. See note 250 supra.
The purpose of such authority is to provide greater flexibility in meeting the corporation's financial needs by allowing segments of a class of preferred to be sold with differing dividend rates, liquidation rights, redemption price, sinking funds, and conversion features, the variance among them frequently being dependent on such matters as market conditions or terms negotiated in private placements. Because of the latitude given to the board of directors in deciding what these variations will be, such shares are frequently referred to as "blank stock." Now, the directors have been given another blank to fill in if they desire with adoption of a TBCA amendment adding voting rights to the matters that can be varied from series to series within senior or special class of shares.

The amendment does not spell out in what manner voting rights can differ from one series to another. The possibility of using multiple or fractional voting has been suggested and there appears no reason why one or more series cannot be denied voting rights, except to the extent permitted by the Act, or have them limited to the occurrence of specified contingencies.

How frequently this permissible variation among series will be used is problematical. Quite often preferred share issues carry no voting rights at

262. The articles must expressly confer authority on the board to divide a class into series and determine the relative rights and preferences as between the series established. Tex. Bus. Corp. Act Ann. art. 2.13(B) (1956). The articles can specify what the variations shall be but this tends to undo the advantage of allowing such matters to be determined later in light of then existent conditions. The Act limits the variations to seven items (dividends, redemption, voluntary and involuntary liquidation, conversion, sinking fund, and voting); otherwise all shares of the class are to be identical. Id. art. 2.13(A) (Supp. 1974). To establish a series the board must adopt a resolution designating the series and fixing and determining its relative rights and preferences which is filed with the secretary of state and there appears no reason why one or more shares of the class are to be identical. Id. art. 2.13(A) (Supp. 1974). To establish a series the board must adopt a resolution designating the series and fixing and determining its relative rights and preferences which is filed with the secretary of state and then becomes an amendment to the articles of incorporation. Id. arts. 2.13(C)-(F) (1956).
266. The Model Act refers to variations in "voting rights, if any" (emphasis added) and it might be argued that omission of the "if any" clause by the Texas draftsmen means that if any series is given a voting right, other series may be given different voting rights but cannot be denied the right to vote altogether. However, article 2.29(A) amended makes clear that voting rights can be denied or limited to the holders of the shares of "any class or series." Tex. Bus. Corp. Act Ann. art. 2.29(A)(1)(a) (Supp. 1974) (emphasis added).
267. The usual contingency is dividends being passed over for several nonconsecutive dividend periods. Another is required approval of certain corporate transactions that might affect the rights of the series, such as the issuance of prior preferred shares, voluntary dissolution, sale of all the assets, etc. See Cary 1223; LaTrin § 139; Buxbaum, supra note 263, at 290-98.
268. Professor Hamilton suggests the whole matter of issuing shares in series is of considerably less importance today than before due to the decline in preferred share financing. 19 R. Hamilton, Texas Business Organizations § 388, at 426.
all unless dividends are passed over for a certain period and it is not likely that if issuable in series, that characteristic would be altered. On the other hand, the blank check feature does leave the corporation's option open so that if voting preferred can be useful in a merger or make a public offering more attractive, it will not be necessary to amend the articles to grant the needed voting rights. It may also be of some aid in structuring the close corporation where, for example, some investors are willing to take preferred stock but not all desire to have voting power. Or possibly in family corporation situations, a father might find it convenient to give a series of voting preferred to older children or those active in the business and a non-voting series to minor children or other relatives. The primary concern, however, should continue to be whether the power thus conferred on the board to mold the corporation's stock structure will be exercised wisely and for the best interests of all concerned.

**Class Voting.** The priorities in payment of dividends or in return of capital on liquidation that holders of preferred shares enjoy are often counterbalanced by the sometimes precarious voting position of such shares. Preferred shareholders are usually not given voting rights unless their dividends are passed over for several periods. Moreover, the voting effectiveness of the preferred stock is substantially diminished because of the normally much larger number of voting common stock that is outstanding. As a consequence, when the number of preferred shares in relation to common are not enough to block adoption of amendments to the articles of incorporation, the preferred shareholders may find themselves at the mercy of the holders of common if the latter choose to amend the articles so as to drastically alter preferred's priorities. To forestall this potential abuse of power, the

269. See note 267 supra.


273. Tex. Bus. Corp. Act Ann. art. 4.01 (Supp. 1974) authorizes a number of amendments that can adversely affect the rights of preferred shareholders, including creation of new preferred with preferences superior or equal to the existing class (subsec. (B)(9)), reduction of the dividend rate or preference (subsec. (B)(7)), or cancelling accrued but unpaid dividends (subsec. (B)(11)). Absent a charter or statutory provision for class voting on such amendments, the only argument that might be used to thwart their adoption is that such an amendment somehow deprives the preferred shareholders of some of their 'vested' property rights, as conferred in the charter's preferred share contract, without due process of law. Cf. Sandor Petroleum Corp. v. Williams, 321 S.W.2d 614, 618 (Tex. Civ. App.—Eastland 1959), error ref. n.r.e., discussed in 14 Sw. L.J. 106 (1960), 38 Texas L. Rev. 499 (1960) (holding adoption of bylaws imposing restrictions on transferability on previously unrestricted shares invalid as an impairment of shareholder's vested property right to realize full value for sale of his stock on open market, although bylaws specifically permitted their amendment by the directors). However, the vested rights argument has been largely repudiated with respect to amend-
Model Act\(^{275}\) and its Texas counterpart\(^{276}\) have long required that certain enumerated amendments\(^{277}\) to the articles that would materially affect the rights of a class can only be adopted if also approved by the holders of a requisite percentage of shares of that class, whether afforded the right to vote by the articles or not.

The protection of preferred's dividend priority need not depend on statutory policy, however. Quite often the terms of a preferred share contract are negotiated by underwriters or private places to provide additional safeguards for the preference.\(^{278}\) These protective provisions may include both

ements adversely affecting the rights of preferred shareholders, largely on the basis that part of every shareholder's contract with his corporation and the state is the reservation of power by the state to amend, repeal or alter its corporation laws as it wishes so as to bind all corporations organized thereunder and their shareholders and the companion power the state confers on its corporations to amend their charters both generally and with respect to specific matters. See, e.g., TEX. BUS. CORP. ACT ANN. art. 9.12 (1956) (reserve power in state); art. 4.01 (Supp. 1974) (corporation's amendatory power). These reservations of power originated in reaction to the Supreme Court's famous decision in Dartmouth College v. Woodward, 4 Wheat. 518 (1819), holding the corporation's charter is a contract between the state and the corporation and cannot be changed by legislative action without unconstitutionally impairing the obligation of contract under U.S. CONST. art. I, § 10, unless the power of amendment had previously been reserved. At one time several states, principally New Jersey and Delaware, took a narrow view of the reserve power so as to invalidate some charter amendments in the absence of explicit legislation previously authorizing such changes, including several cases dealing with attempts to eliminate arrearages on preferred; see, e.g., Morris v. American Pub. Util. Co., 14 Del. Ch. 136, 122 A. 696 (1923); Keller v. Wilson & Co., 21 Del. Ch. 391, 190 A. 15 (1936); Consolidated Film Indus. Inc. v. Johnson, 22 Del. Ch. 407, 197 A. 489 (1937); Zabriski v. Hackensack & N.Y.R.R., 18 N.J. Eq. 178 (Ch. 1867), but later decisions either repudiated the earlier views, see, e.g., Brundage v. New Jersey Zinc Co., 48 N.J. 450, 226 A.2d 585 (1967), or else permitted other devices to be used to affect preferred's rights, e.g., Federal United Corp. v. Havender, 24 Del. Ch. 318, 11 A.2d 331 (1940) (merger into wholly-owned subsidiary); Shanik v. White Sewing Mach. Corp., 25 Del. Ch. 134, 15 A.2d 169 (1940) (creation of prior preferred as part of voluntary reorganization plan). As a consequence, the "vested rights" doctrine has virtually disappeared, thus still leaving preferred at the mercy of the majority's legal power to amend (assuming there are no statutory or charter class voting rights) except as equity might limit such power to prevent fraud or oppression. In general see, e.g., CARY 1768; LATTIN §§ 155-59; Conard, Manipulation of Share Priorities, 8 VAND. L. REV. 54 (1954); Curran, Minority Shareholders and the Amendment of Corporate Charters, 32 MICH. L. REV. 743 (1934); Dodd, Amendment of Corporate Charters, 75 U. PA. L. REV. 585, 723 (1927); Gibson, How Fixed Are Class Shareholder Rights, 23 LAW & CONTEMPT. PROB. 282 (1958); Lattin, A Primer on Fundamental Corporate Changes, 1 WESTERN RESERVE L. REV. 3 (1949); Lynch, The Majority's Power to Effect Fundamental Changes in Shareholders Rights, 2 CORP. PRAC. COM. No. 4, 1961, at 1.

274. This often involved the elimination of accumulated arrearages. See note 273 supra, and authorities there cited. See, e.g., Becht, Alterations of Accrued Dividends, 49 MICH. L. REV. 363 (1951); Becht, Corporate Charter Amendments: Issues of Prior Stock and the Alteration of Dividend Rates, 50 COLUM. L. REV. 900 (1950); Dodd, Accrued Dividends in Delaware Corporations—From Vested Right to Mirage, 57 HARV. L. REV. 894 (1944); Latty, Exploration of Legislative Remedy for Prejudicial Changes in Senior Shares, 19 U. CHI. L. REV. 759 (1952); Linde, Elimination of Dividend Arrearages on Cumulative Preferred Stock by Amendment of the Articles of Incorporation, 37 CALIF. L. REV. 129 (1949); Waterbury, Elimination of Dividend Accumulations by Direct Charter Amendment, 48 MICH. L. REV. 657 (1950). As suggested by the number of articles cited, the literature on alteration of preferred shareholders' rights has been voluminous. See 2 ABA MODEL BUS. CORP. ACT ANN. 2d, at 239 for a comprehensive list of references.

275. ABA MODEL BUS. CORP. ACT ANN. 2d, § 60.

276. TEX. BUS. CORP. ACT ANN. art. 4.03 (Supp. 1974).

277. The TBCA lists a total of 13 amendments that require class voting, including any amendment that would "cancel or otherwise affect dividends on the shares of such class which had accrued but had not been declared." TEX. BUS. CORP. ACT ANN. art. 4.03 (Ch. 4) § 19. The last three amendments were added in 1973 to accommodate the new close corporation statutes. See text accompanying note 27 supra.

278. On the preferred share contract in general, see LATTIN 501; Buxbaum, Preferred
voting rights in certain specified situations, primarily contingent rights to participate in the election of the board if dividends are passed over or to approve charter amendments or acquisitions that may affect preferred's prerogatives, and varying types of financial restrictions. The latter may include minimum asset requirements, or retention of sufficient working capital after dividends are paid, or floors on consolidated net income in relation to all dividend payouts and repurchases of common. Possibly in recognition of the principle that preferred should be entitled to no more protection than can be bargained for, article 4.03 was amended in 1967 to preclude class voting on certain specified amendments if the articles of incorporation relative to a class denied it the right to vote on such amendments and contained provisions setting out specific limitations and restrictions within which the corporation could take action covered by the amendments. Amendments for which class voting could thus be denied included those that would increase the number of shares of the class, or create a new class with equal, prior, or superior rights, or increase the rights and preferences of junior securities to a rank equal to or superior to the class.

As drafted, the 1967 amendment, which was not sponsored by the Bar Committee, was scarcely a model of clarity (and not just because it did not have the committee's imprimatur). Despite efforts to rationalize its thrust and intent, made more difficult by its cryptic legislative history, it was evident the new section would remain a source of confusion as to its meaning unless revised or repealed. Moreover, its terms were contrary to the basic philosophy behind the class voting privilege, namely to afford some protection to purchasers of preferred stock who after its issuance are seldom

\[\text{Stock—Law and Draftsmanship, 42 CALIF. L. REV. 243 (1954) (an excellent discussion and practice guide).}\]

\[279. \text{See Buxbaum, supra note 278, at 290.}\]

\[280. \text{See HENN. 298; Buxbaum, supra note 278, at 255.}\]

\[281. \text{Ch. 633, § 1, [1967] Tex. Laws 1758, adding section C to TEX. BUS. CORP. ACT ANN. art. 4.03 (1956) (repealed 1973), discussed in Amsler, supra note 127, at 67.}\]

\[282. \text{Ch. 663, § 1, [1967] Tex. Laws 1758 (repealed 1973).}\]

\[283. \text{E.g.:}\]

\[C. \text{The provisions of Paragraph B of this Article 4.03 shall not apply to the holders of outstanding shares of any class not entitled to vote upon a proposed amendment by the provisions of the Articles of Incorporation, in the case of an amendment which would increase the aggregate number of authorized shares of such class or create a new class of shares having rights and preferences equal, prior, or superior to the shares of such class, or increase the rights and preferences of any class having rights or preferences later or inferior to the shares of such class in such a manner as to become equal, prior to superior to the shares of such class, if the provisions of the Articles of Incorporation applicable to such class set forth specific limitations and restrictions within which the corporation may take the action contemplated by the proposed amendment, and if the action contemplated by the proposed amendment is within the limitations and restrictions so specified.}\]

\[\text{Id.}\]

\[284. \text{The amendment's emergency clause stated: "The fact that the Texas Business Corporation Act may now require voting on amendments by certain classes of stock which by the original Articles of Incorporation and amendments thereto and by the provisions of the applicable stock certificates are not entitled to vote, and the further fact that certain amendments are necessary for the continued effective administration of the Texas Business Corporation Act, creates an emergency . . . ." Ch. 663, § 3, [1967] Tex. Laws 1758.}\]
in a position to renegotiate its terms. All that could be hoped for, so long as the section remained in force, was that somehow the protection provided in the articles would fairly protect the preferred shareholders from serious erosion in the value of their holdings. Given this background, it should not be surprising that when the Bar Committee recommended the section be repealed, it was.

Four other amendments, already noted, may have some impact on class voting. Although there may now be variations in voting rights among series of a class of preferred or special class of stock, all the holders of the class will continue to be permitted to vote on any amendments to the articles that require the class approval under the Act, even though some of the series are made non-voting. Second, the number of votes needed for approval by a class can be reduced to that cast by the holders of a majority or more of the shares. Third, a class of shares may be given more or less than one vote per share. While this will not affect the percentage required for approval within the class, it may become a definite factor in determining the total vote of all the holders of the shares needed for approval of amendments or other actions. Finally, any amendment to the articles of a statutorily-defined close corporation to permit or rescind the privilege of having its business and affairs managed by its shareholders rather than by a board of directors or giving one or more of its shareholders the option to dissolve the corporation must be approved by the vote to all classes.

286. E.g.: Earlier purchasers of preferred should, in fairness, be protected in the articles from a serious erosion in the value of their holdings by a provision, for example, that the net worth attributable to the outstanding preferred shall not be reduced by the new issue below a certain specified amount per share, or that the common equity shall be maintained at a certain percentage in relation to the total preferred outstanding after the additional issue, or that the additional issue shall not constitute more than a specified percentage of the cost of the new capital additions, etc. If these protective restrictions and conditions in the articles permitting such an amendment have been complied with, the 1967 addition of Section C to Art. 4.03 makes the limitation or denial of the class vote in the articles effective as applicable to this type of amendment.

Comment of Bar Committee to Art. 4.03, 3A Tex. Rev. Civ. Stat. Ann. (Supp. 1972). Because section C has been repealed, these observations no longer appear in the Committee's Comment to article 4.03. Nor can they be found in the bound volume containing the original TBCA published in 1956, for the obvious reason that section C was not enacted until 1967. Thus, due to the ephemeral nature of pocket part supplementation, this comment, like others formulated after 1956 but subsequently revised, will simply disappear in law libraries that discard supplanted pocket parts, as nearly all do. Perhaps there ought to be a publication somewhat equivalent to session laws to preserve replaced legislative commentary as a source of legislative history.

290. Id. art. 4.03.
291. Id. art. 9.08, discussed in text accompanying notes 28-36 supra.
292. Id. art. 2.29(A)(1)(a), (2), discussed in text accompanying notes 206-26 supra.
293. Id. art. 2.30-1(A).
294. Id. arts. 2.30-1(B), (C).
295. Id. art. 2.30-5.
whether a class is otherwise given the right to vote or not.296

Voting of Shares: Proxy Contest. Battles for control of publicly-held corporations have tended in recent years to be largely waged on the field of competing or resisted tender offers.297 Now and then, however, a good old-fashioned proxy contest appears to provide the opportunity for formulating or further clarifying some of the rules that govern this form of intercorporate combat. Aside from the federal proxy rules299 which apply only to large publicly-held corporations,299 much of the law in point deals with such matters as the legality of the call,300 notice,301 and conduct302 of the shareholders' meeting to elect directors, the nature and duration of the proxy power,303 and

296. Id. arts. 4.03(B)(11)-(13).
the eligibility of various shareholders to vote in the contest.\textsuperscript{304} If litigation ensues, as is likely to be the case if the contested election is close, further problems arise that concern the propriety of the remedy being sought and the standing of the complaining party.\textsuperscript{305} In a recent decision by the Dallas court of civil appeals, \textit{Salgo v. Matthews},\textsuperscript{306} some of these issues were considered in a scholarly and wide-ranging opinion by Justice Guittard.

The \textit{Salgo} case involved a proxy contest for control of a Texas company waged between two competing slates of candidates at a special meeting of the shareholders. The president, a candidate for re-election to the board on management's slate, appointed a Dallas attorney as election inspector to count the votes. The meeting was recessed until the next day while the proxies were tabulated. During that time the two principals in the insurgent group presented several proxy documents executed in their behalf in the name of a casualty company, the record owner, signed by the beneficial owner (who was in bankruptcy) and another signed by the state receiver of the casualty company, all pursuant to an order of a state district court that the proxies be executed in their favor. The inspector refused to accept any of these documents as proxies nor would he accept two telegraphic proxies from other shareholders presented later the next day but before the results were sought to be certified. Had all these proxies been counted, the non-management slate would have won. The following day the two non-management group principals obtained a temporary restraining order, later made into a temporary injunction, ordering the president and the inspector not to accept any more proxies, or to refuse to count the disputed proxies, or to certify the final vote count until the validity of the disputed proxies had been resolved. After a hearing on the merits, the court ordered the president to reconvene the meeting and announce the non-management slate as the victor in the voting, because in its judgment the disputed proxies should have been counted. On appeal the issues raised concerned the role of the inspector, the voting of the shares by the receiver or beneficial owner, the timeliness of the telegraphic proxies, and most importantly, the appropriateness of injunctive relief. The Dallas court's holdings on all these points warrant discussion.

\textit{The Remedy: Injunction, Mandamus, or Quo Warranto?} As the court noted, quo warranto is generally regarded as the proper and traditional remedy to test the validity of a corporate election and the title of those who claim corporate office.\textsuperscript{307} Within the framework of its historical development\textsuperscript{308}
and statutory authorization, this extraordinary legal proceeding empowers a court to remove those who wrongfully hold or usurp public or corporate offices and to replace them with the rightful occupants. Because of the adequacy of the quo warranto remedy in most contested election cases, a corollary general rule states that equity will not accept primary jurisdiction to determine the legality of a corporate election or remove a director from his position unless the issue is collaterally raised in a suit over which its jurisdiction is unquestioned. Finding no reason not to apply these general standards where the only real issue was title to the office of director, the court reversed the trial court's decree.

The court justified its decision on the soundness it perceived in the policy that bars the award of extraordinary mandatory relief, either by way of injunction or mandamus, if another effective and complete remedy can be found, and rejected any notion that tradition or a mechanistic application of precedent dictated the result. In its view, quo warranto was no more time-consuming or expensive a proceeding than those asking for a mandatory injunction or mandamus and in a corporate election case gave more effective relief. For example, the trial court's order did not really resolve the controversy before it, since only the results of the election were announced. It did not oust the management directors from office and install the plaintiffs' slate, as in quo warranto; for that matter, the order could not have, since not all the management directors were named as parties to the suit.

The appellate court conceded there might be times when mandatory injunctive relief should be granted, such as when there has been a refusal to hold an election or a failure to count votes cast and declare results, or action taken that will frustrate or seriously delay the elective process. In

of writs of right. It was later replaced in England by the form of an information in the nature of quo warranto and became part of the law in this country either by adoption of the common law or by statute. At one time the remedy could not be used to question the validity of a corporate official's appointment or election to office since it was thought to apply only to public officials. However, because of the quasi-public nature of corporations as agents of the state, quo warranto became the principal mode of testing one's right or title to corporate office. See generally F. Ferris & F. Ferris, The Law of Extraordinary Legal Remedies §§ 101-03, 154 (1926); 5 W. Fletcher, Cyclopedia Corporations §§ 2324-26, 2335; C. Kinnane, A First Book on Anglo-American Law 662 (2d ed. 1952).

309. Tex. Rev. Civ. Stat. Ann. arts. 6253 (authorizing attorney general or proper district or county attorney to petition court to file information in nature of quo warranto in name of state therein if, inter alia, "any person shall usurp, intrude into or unlawfully hold or execute . . . any office in any corporation created by the authority of this State . . . ."), 6257 (if person adjudged guilty as charged, he may be ousted from office, fined, and suffer court costs) (1970).


deed, equity's aid is frequently invoked to restrain fraud or misrepresentation in the solicitation of proxies\textsuperscript{312} or prevent meetings from being held that contravene notice, time, or subject matter requirements\textsuperscript{313} or to preclude interference with the board's management during the course of the election contest.\textsuperscript{314} But even in these cases, the courts generally require some showing of irreparable harm and inadequacy of other remedies.\textsuperscript{315} Moreover, in cases such as the one before it, in which apparently for the first time in Texas jurisprudence judicial assistance was being sought to control a corporate election before its results were announced,\textsuperscript{316} there is great need for letting matters be decided internally before seeking judicial help. As Justice Guittard aptly put it:

If, while the meeting is still in progress, opposing factions may take their disputes to court and require judicial determination of the regularity of the proceedings, eligibility of voters and validity of proxies, the affairs of the corporation may be brought to a standstill by restraining orders, hearings and appeals, courts may be occupied by matters of little or no ultimate consequence, and judicial processes may be employed as tactics for the advantage of one faction or another in their struggle for the support of other stockholders. Unless immediate judicial intervention is shown to be essential to protect substantial rights, opposing factions should be required to fight their battles to a conclusion one way or another within the corporate arena before seeking the aid of the courts.\textsuperscript{317}

As to mandamus, the court first noted that that remedy is also governed by general equitable principles;\textsuperscript{318} thus its appropriateness, too, depends on the inadequacy of other relief.\textsuperscript{319} Secondly, in response to an argument that


\textsuperscript{313} See generally 5 W. FLETCHER, CYCLOPEDIA CORPORATIONS § 2071.


\textsuperscript{315} 497 S.W.2d at 626.

\textsuperscript{316} Id. at 625.

\textsuperscript{317} See authorities cited in note 196 supra.

\textsuperscript{318} See Wells v. Commissioners' Court, 195 S.W. 608 (Tex. Civ. App.—El Paso 1917), error ref., a case the Dallas court found quite persuasive, refusing to grant mandamus to require election officials to canvass the returns of a particular precinct, because quo warranto was the more appropriate remedy. Even if the election officials had given a new certificate of election based on the mandamused recount, it would have only been
the election inspector at least could be mandamused, the court declined to follow the suggestion of Aranow and Einhorn,\textsuperscript{320} that to alleviate the disruption and expense involved in post-election contest litigation, it would be desirable to have the courts mandamus election inspectors and thus provide quick judicial review of their rulings before results are announced. Conceding the mandamus remedy might be an expeditious and conclusive one in such cases,\textsuperscript{321} the fact remained the plaintiffs initiated the whole time-consuming procedure in equity of temporary orders, motions to dissolve, interlocutory appeals, and trial and appeal on the merits—hardly a summary remedy to quickly resolve a proxy contest when quo warranto would ultimately do the job in no more time.\textsuperscript{322} It should also be noted that New York, where mandamus has been used in such cases, has adopted a special procedure for contested election cases that provides more summary relief\textsuperscript{323} and even Aranow and Einhorn concede there is scant legal authority on the availability of mandamus in such situations.\textsuperscript{324}

In view of the state of the law on judicial remedies in Texas, the court’s conclusion as to the appropriateness of quo warranto as the best form of relief was undoubtedly sound. Yet had it not gone on to resolve the validity of the disputed proxies,\textsuperscript{325} the parties might well have found themselves back where they started after months trying to get a definitive ruling. True, the court’s holding in \textit{Salgo}, if generally followed, will furnish a useful guide hereafter in other contested election cases. But in light of the uncertainties remaining so long as several overlapping remedies are possibly available, it would seem much more desirable to recognize proxy contests as sui generis and, as several states have done,\textsuperscript{326} provide a specific summary proceeding

\textit{prima facie evidence of the right to office, an issue that would ultimately have to be decided in quo warranto. The Dallas court felt the same reasoning applied to corporate elections especially where extraordinary relief was being sought before the election. 497 S.W.2d at 627.}

\textsuperscript{320} E. ARANOW & H. EINHORN, supra note 298, at 492.


\textsuperscript{322} As the court noted, an appeal in quo warranto must be perfected and the transcript and statement of facts filed within 20 days after the trial court’s final judgment or order overruling a motion for new trial, unless a reasonable extension of time is granted, TEX. R. CIV. P. 384; moreover, the appellate court must give preference to the appeal and hear and determine it as early as practicable. TEX. R. CIV. P. 781. \textit{See generally L. LOWE, supra note 192, \S\S 1271, 1274.}

\textsuperscript{323} N.Y. BUS. CORP. LAW \S 619 (McKinney 1963), \textit{discussed in E. ARANOW & H. EINHORN, supra note 298, at 497-518.}

\textsuperscript{324} On motion for rehearing, the Dallas court rejected an argument that the quo warranto proceeding was unconstitutional because it made protection of voting rights dependent on the exercise of discretion by prosecuting attorneys to bring the action, since no showing was made that these officials would not perform their duty. 497 S.W.2d at 632.

\textsuperscript{325} \textit{See discussion in text accompanying notes 342-57 infra.}

\textsuperscript{326} CAL. CORP. CODE ANN. \S\S 2236-38 (West 1955); CONN. GEN. STAT. ANN. \S 33-315 (Supp. 1973); DEL. CODE ANN. tit. 8, \S\S 225, 227 (1967); IDAHO CODE \S 30-
in which the court will have broad powers to enter whatever orders that may be needed to resolve these disputes. These special statutory proceedings afford a flexible and simplified procedure that avoids the pitfalls of traditional judicial remedies classification and enables a court both to effectively deal with all the legal sparring that marks the proxy contest and to rapidly determine the legitimacy of the combatants' competing claims to corporate office.

Role of Election Inspector. To further support the trial court's order, the plaintiffs argued relief was necessary because the election inspector had abused his authority in not accepting the disputed proxies. His function, they said, was purely ministerial and so long as the proxies appeared valid on their face they should not have been rejected. The court recognized there is some case authority that so describes the inspector's duties, but specifically held, nevertheless, that an election inspector has discretionary authority to preliminarily determine the validity of proxies for purposes of tabulation, counting votes, and certifying results and that in the exercise of those duties he is not subject to judicial control, although his decision is thereafter reviewable through quo warranto proceedings. As a consequence, his exercise of discretion in performing this function cannot be controlled by mandamus or mandatory injunction.

Since Salgo is the first Texas decision on the role of the election inspector, there being nothing in the TBCA or in the corporation's bylaws on the matter, the Dallas court's opinion obviously has made some new law, although not necessarily inconsistent with holdings elsewhere. It believed


327. Under the Maine statute, for example, the court can compel the production of documentary evidence, issue interlocutory orders restraining directors and officers whose positions are being contested from acting or dealing with other matters prior to final determination if the court deems proper, and by way of final relief, declare the results of the election, or order a new one including use of a master to conduct the election, determine voting rights of shareholders or those claiming the right to vote, decide if there have been breaches of voting agreements or trusts, and finally "direct such other relief as may be just and proper." Me. Rev. Stat. Ann. tit. 13A, § 621 (1974).

As to use of a master to supervise a new election, see Tarver v. Mitchell, 265 S.W. 1106 (Tex. Civ. App.—San Antonio 1924) (affirming trial court order setting aside election but reversing that part of order appointing master to conduct new election and report back to court).


329. 497 S.W.2d at 627.

330. Id. at 628.

331. Several courts and authorities state that the inspector's duties are at least quasi-judicial, at least insofar as determining the eligibility to vote, or keeping the polls open so that all shareholders can vote, are concerned. See, e.g., Clopton v. Chandler, 27 Cal.
its ruling would best serve the interest of the shareholders in permitting proxy contests to be promptly resolved by allowing the inspector to perform his function of accurately determining and promptly announcing the result of the voting without interruption by litigation brought by the opposing factions.\(^3\)\(^3\)\(^2\) This of course is a policy decision, as the court's language quoted earlier plainly reveals,\(^3\)\(^3\)\(^3\) and certainly there is considerable merit in not having the announcement of the poll delayed by constant resort to interlocutory proceedings. The time in which the inspector performs his duties is so short anyway that no great harm can come to a contestant if he is allowed to play his role, provided (and the proviso is quite important) his decision can be expeditiously reviewed. While the court seemed confident the quo warranto remedy suffices for that purpose, a summary procedure if enacted would safeguard the interests of all the contestants even more effectively because of the wider range of options it can enable the court to promptly make.\(^3\)\(^3\)\(^4\) Otherwise, any protracted delay simply means the persons apparently elected will continue to serve at least as de facto directors until their election has been set aside.\(^3\)\(^3\)\(^5\)

As the court observed, there is no Texas statute on the appointment of election inspectors, although the practice is fairly common in meetings of large publicly-held corporations.\(^3\)\(^3\)\(^8\) Certainly in light of the discretionary authority Salgo vests in them, they should be chosen with care.\(^3\)\(^3\)\(^7\) Indeed, if they are to fully play the protected role the Dallas court perceived for them, it would again seem much more desirable to have the legislature prescribe the right to and method of their appointment, and more importantly, the scope of their duties and the standards by which they are to be exercised.

A number of states have such statutes\(^3\)\(^3\)\(^8\) and they specify the needed details that hardly can be expected from judicial legislation. The New York statute,\(^3\)\(^3\)\(^9\) for example, provides that the inspectors, who may be appointed by the board or the presiding officer unless otherwise provided in the...
bylaws, and who must be appointed if a shareholder demands, after taking an oath to fulfill their duties with strict impartiality and to the best of their abilities, are to determine the number of voting shares outstanding and how many are represented at the meeting, whether a quorum is present, and the validity and effect of proxies; receive the votes; hear and determine all challenges and questions raised in voting and if requested make a report in writing thereon and execute a certificate as to any fact they find; count and tabulate the votes; determine the results; and do everything proper to conduct the election or vote "with fairness to all shareholders." As useful as the Salgo decision is in establishing new guidelines for election inspectors in Texas, it would be even more helpful if a statute such as New York's or similar legislation elsewhere were made part of the TBCA.

Voting by Receiver. Under the TBCA a receiver may vote the shares standing in his name or, even if they have not been transferred to him on the corporation's books, any he holds or that are under his control when authorized by order of the court appointing him. In the Salgo case, the most pivotal of the proxies rejected by the election inspector were those for shares owned by an insurance company in receivership. The inspector was presented with four documents covering 29,934 shares owned by Pioneer Casualty Company. Two were proxies signed by one Sheperd, the beneficial owner to whom the shares had been transferred. A third was an order of a Travis County district court directing Pioneer's receiver to give Sheperd a proxy to vote these shares so that Sheperd could then give his proxy to the two plaintiff-insurgents (which the court regarded the same as if the receiver had directly given the proxy to the plaintiffs) and the fourth was the receiver's proxy so executed. Because Sheperd was bankrupt, the defendants contended beneficial ownership in the shares was in the trustee in bankruptcy, not in Pioneer or Sheperd, and consequently neither Sheperd nor the receiver had the right to vote the stock, just as the inspector had determined.

In deciding the receiver's proxy should have been counted, the court acknowledged that under the bankruptcy law whatever beneficial interest Sheperd had in stock vested in his bankruptcy trustee, but this did not necessarily mean the trustee alone had power to vote the shares as beneficial owner without their being transferred to him on the corporation's books. For until they were, the little authority there is on the point indicates a bankrupt can continue to vote his stock at least until notice has been given the corporation of the bankruptcy and vesting in the trustee. Moreover, under the TBCA, the corporation's stock transfer records are prima facie evidence

340. The Maine statute makes the clerk or the secretary of the corporation the voting inspector, subject to other provisions in the bylaws or the discretion of the presiding officer. ME. REV. STAT. ANN. tit. 13A, § 609 (Supp. 1974).
342. TUX. BUS. CORP. ACT ANN. art. 2.29(G) (1956).
as to who are shareholders entitled to vote\textsuperscript{345} and insofar as the election inspector is concerned, these records are conclusive on the question of eligibility to vote.\textsuperscript{346} If there is any conflict concerning disputed ownership, it must be resolved later by the courts. This view seems somewhat in conflict with the rather broad discretionary authority the court had just recognized the election inspector as having, although certainly consistent with general law elsewhere.\textsuperscript{347} Furthermore, the trustee here made no effort to have the shares transferred in his name or to have the receiver or the receivership court issue a proxy to him or pursue any of the other remedies of the beneficial owner who desires to vote.\textsuperscript{348}

Since Pioneer was the record owner, the only matter to be resolved by the inspector was to determine who had the right to represent it.\textsuperscript{349} Having no officers and being in receivership, it seemed manifest under the TBCA that only the receiver acting pursuant to a court's order could vote for it.\textsuperscript{350} However, the defendants argued that the shares in question were not "held by" or "under the control" of the receiver, the operative language of article 2.29(G), because apparently having been pledged to a Detroit bank either the bank or the trustee as beneficial owner had "control" of them. In response, the court said the statute did not mean the receiver had to have either actual physical control of the stock certificates or beneficial ownership; rather so long as the shares are recorded in the name of the corporation in receivership on the books of the issuing corporation, its receiver "holds" the shares. The court's interpretation is a sensible one, even though it leaves open the question of a possible conflict in determining voting authority among two judicially appointed officers or representatives,\textsuperscript{351} something neither the Model Act\textsuperscript{352} nor its TBCA counterpart addresses itself to.

**Timeliness of Proxies.** The question of how long the polls should remain open so that a shareholder may cast his vote or have his proxy received is

\textsuperscript{345} Tex. Bus. Corp. Act Ann. art. 2.27(A) (1956).
\textsuperscript{346} E.g., Williams v. Sterling Oil of Oklahoma, Inc., 273 A.2d 264 (Del. 1971); In re Schirmers Will, 231 App. Div. 625, 248 N.Y.S. 497 (1931); In re Argus Printing Co., 1 N.D. 434, 48 N.W. 347 (1891). See generally E. Aranow & H. Einhorn, supra note 298, at 385; 5 W. Fletcher, Cyclopedia Corporations §§ 2018, 2033; Axe, supra note 328, at 63. In the Williams case, supra, the court held that if identical but conflicting proxies are presented which cannot be resolved from the face of the proxies themselves or the corporate records, they must all be rejected.
\textsuperscript{347} See generally 5 W. Fletcher, Cyclopedia Corporations 110; Annot., supra note 328.
\textsuperscript{348} As the court noted, the beneficial owner can demand a proxy from the record owner and seek relief by way of damages, an injunction, or mandamus if the latter refuses. See, e.g., Commissioner v. Southern Bell Tel. & Tel. Co., 102 F.2d 397 (6th Cir. 1939); In re Giant Portland Cement Co., 26 Del. Ch. 32, 21 A.2d 697 (Ch. 1941); In re Canal Constr. Co., 21 Del. Ch. 155, 182 A. 545 (Ch. 1936); see generally E. Aranow & H. Einhorn, supra note 298, at 387; Cary 289; 5A Z. Cavitch, supra note 21, § 109.02[2], at 996-97; cf. Maidman, Voting Rights of After-Record-Date Shareholders: A Skeleton in a Wall Street Closet, 71 Yale L.J. 1205 (1962).
\textsuperscript{349} 497 S.W.2d at 630.
\textsuperscript{350} Tex. Bus. Corp. Act Ann. art. 2.29(G) (1956).
\textsuperscript{351} Cf. Cooper v. Citizens Nat'l Bank, 267 S.W.2d 848 (Tex. Civ. App.—Waco 1954), error ref. n.re., discussed in 19 R. Hamilton, Texas Business Organizations § 478, at 509 (testamentary trustee prevailed over independent executor in dispute over right to vote decedent's stock). See also In re Empire Fin. Corp., 1 F. Supp. 298 (N.D. Cal. 1932) (trustee in bankruptcy and not previously appointed receiver authorized to vote stock owned by bankrupt corporation).
\textsuperscript{352} ABA Model Bus. Corp. Act Ann. 2d, § 33.
one seldom dealt with by statute or even in the corporation's bylaws. If nothing is said, presumably they may be ordered closed by action of the shareholders, the presiding officer, or the inspectors of the election, but even after that time they may be accepted or the vote changed so long as the results of the voting have not been announced. The court applied these general principles in determining the two telegraphic proxies should have been counted. Although presented the day following the meeting, the meeting had only been recessed and not adjourned nor had the results been announced. Absent a controlling bylaw, agreement or other binding provision concerning an earlier closing of the polls, the court said, the shareholder retains his right to change his vote up until the final announcement of results.

Management by Shareholders. Among the more far-reaching aspects of the close corporation legislation adopted in 1973 and noted in the next part of this survey are the sections that allow shareholders of a close corporation either to dispense with the board of directors and directly assume the prerogatives of management or else to provide beforehand by agreement many of the matters that normally fall within the discretion or powers of the board of directors. The choice for direct management by the shareholders can be made in the original articles of incorporation or by an amendment thereto; an agreement that impinges on the board's powers of management must be one that all the shareholders of the close corporation have assented to and meets other requisites. In either case, the shareholders may then become subject to the various liabilities imposed by the Act or by law for abuse or neglect of their managerial duties. These provisions are treated in more detail in Part III but need to be mentioned here to demonstrate the possibility of attaining the ultimate in shareholder action and control.

353. New Jersey formerly required that the polls remain open from nine o'clock in the morning until five o'clock in the afternoon with mandatory closing by nine in the evening, but the requirement has been repealed. Ch. 185, § 34, [1896] N.J. Laws 289, as amended, N.J. STAT. ANN. § 14A:5-24 (Supp. 1974); see Commissioners' Comment to § 14A:5-24, 14 N.J. STAT. ANN. 238 (1969).


355. Id. See also 6 Z. CAVITCH, supra note 21, § 117.05[1], at 464; 5 W. FLETCHER, CYCLOPEDIA CORPORATIONS § 2017, at 101.


358. TEX. BUS. CORP. ACT ANN. art. 2.30-1(B) (Supp. 1974), discussed in text accompanying notes 535-37 infra.

359. TEX. BUS. CORP. ACT ANN. art. 2.30-2(A) (Supp. 1974), discussed in text accompanying notes 538-43 infra.

360. TEX. BUS. CORP. ACT ANN. art. 3.02(A)(9) (Supp. 1974), discussed in text accompanying note 24 supra.

361. TEX. BUS. CORP. ACT ANN. art. 4.01(B)(18) (Supp. 1974), discussed in text accompanying notes 25-27 supra.

362. TEX. BUS. CORP. ACT ANN. art. 2.30-2 (Supp. 1974), discussed in text accompanying notes 538-43 infra.

363. TEX. BUS. CORP. ACT ANN. arts. 2.30-1(B)(2), -2(E) (Supp. 1974).
B. Action by Directors

Number of Directors. As part of the trend toward removing some of the formalities of corporate government for what are essentially incorporated proprietorships or two-man partnerships, a TBCA amendment reduces the number of directors a corporation must have to one or more. The almost universal minimum heretofore has been three directors which has led to the practice in the case of the one-man close corporation of utilizing persons such as family members, employees, or less frequently the company's attorney, to serve for all practical purposes as dummy directors, content to do the bidding of the owner when called upon to pass resolutions or sign documents, often their sole function, yet frequently unaware of their fiduciary responsibilities or the risks of obeisance. Any show of independence by these nominal or non-shareholder directors can easily be curtailed if foresight has been used in providing for removal of directors without cause by the shareholders. Although the anomaly of a one-man board of directors, the change squares the law with the reality of how these incorporated businesses operate in fact and should reduce still further the possibilities of negation of corporate transactions for want of formality.

In one respect, however, the amendment (and its Model Act source) goes beyond legislation in some states which also countenance a board of less than three members. Those states permit the reduction in number of directors to one or two only where there are less than three shareholders and add the further proviso that the number of directors may not be less than the number of shareholders. While on its face this appears to be a reasonable

366. See Doty & Parker 1020.
368. See F. O'Neal, Close Corporations §§ 3.13, 3.59. See also discussion in text accompanying notes 426-45 infra.
370. See, e.g., Hurley v. Ormsteet, 311 Mass. 477, 42 N.E.2d 273 (1942); Gerard v. Empire Square Realty Co., 195 App. Div. 244, 187 N.Y.S. 306 (1921); Curtis v. Pipeline Corp., 370 S.W.2d 764 (Tex. Civ. App.—Eastland 1963). However, the courts have tended to overlook informalities in action by the directors when the corporation has gained substantial benefit therefrom or when the board and the shareholders are the same. See generally R. Hamilton, Texas Business Organizations § 559; F. O'Neal, Close Corporations § 8.03.
371. ABA Model Bus. Corp. Act Ann. 2d, § 36. Prior to the 1969 revision, the Model Act required a minimum of three directors, but removed the minimum to recognize the growing practice of one-man management in close corporations. Id. ¶ 2.
compromise in policy and there is no great likelihood a board of less than
three directors will be employed in corporations where there are a number
of active or substantial shareholders, these statutes remove an element of
flexibility in business planning the TBCA amendment affords. For example,
there may be cases where shares have been given to or purchased at nominal
cost by more than three family members or employees; yet the father or em-
ployer wants a one-man directorship in order to continue to operate without
interference what he still conceives to be his business.

Another aspect of the same amendment also gives more flexibility in deter-
mining how the number of directors will be fixed. Under the TBCA as first
enacted, the bylaws stipulated how many directors there would be except for
the first board whose number was to be fixed in the articles of incorpora-
tion.873 This meant that whenever an increase or decrease in number was
desired, the bylaws had to be amended.874 This might or might not be a
good deal of bother, depending largely on whether the shareholders retained
the power to amend the bylaws or had delegated that authority to the direc-
tors.875 It also left open the rather intriguing possibility that even though
the shareholders provided in the articles for a specific number of directors,
not only for the first board but during the life of the corporation, a contrary
bylaw adopted by the directors (assuming the amendatory power had been
delegated to them) would prevail.876

Employing the 1969 revision of the comparable Model Act section,877 the
1973 TBCA amendment deals with both of these problems by permitting the
number of directors to be determined either by, “or in the manner provided in,”
the articles or bylaws.878 Similarly, their number can be increased or
decreased by amendments to, or in the manner provided by, either of those
documents.879 For example, the articles or bylaws can stipulate that the
number of directors can be within a certain range with the precise number
to be fixed from time to time by the shareholders or the board,880 presumably
by formal resolution, although informal acquiescence may well suffice,881 or

1973); N.C. GEN. STAT. § 55-25(a) (Supp. 1973); ORE. REV. STAT. § 57.185 (1969);
R.I. GEN. LAW ANN. § 7-1.1-34 (Supp. 1973); TENN. CODE ANN. § 48-802(a) (Supp.
1973).
373. Ch. 64, art. 2.32, [1955] Tex. Laws 239, as amended, TEX. BUS. CORP. ACT
Ann. art. 2.32 (Supp. 1974). If the bylaws were silent, the number remained the same
provided in the articles. There has been no change in this general rule.
374. Comment of Bar Committee to Art. 2.32, 3A TEX. REV. CIV. STAT. ANN. 90
(Supp. 1974); Doyt & Parker 1021.
375. See text accompanying notes 61-68 supra.
376. See Gow v. Consol. Coppermines Corp., 19 Del. Ch. 172, 165 A. 136 (1933),
upholding a bylaw instituted by successful insurgents increasing the number of directors
from nine to fifteen, although the charter provided for a nine-man board. The result
in Gow was overturned by later legislation. See note 384 infra.
377. ABA MODEL BUS. CORP. ACT ANN. 2d, § 36.
art. 2.32 (1956).
379. TEX. BUS. CORP. ACT ANN. art. 2.32 (Supp. 1974).
416 (1949), upholding a similar bylaw.
381. See, e.g., Keating v. K-C-K Corp., 383 S.W.2d 69, 71 (Tex. Civ. App.—Houston
1964) (where articles provided number of directors to be that fixed in bylaws, but no
less than three, action of shareholders in electing four directors for past four years
as in one case, not provide a specific number but state that the number of directors shall consist of those whose terms have not expired plus the number just elected by the shareholders. Or, in a close corporation, there may well be a provision that there can be no increase or decrease in number without the unanimous consent of the shareholders. Likewise, it should no longer be possible for a bylaw relating to the number of directors to override a contrary provision in the articles of incorporation.

*Quorum for Directors’ Meeting.* Article 2.35, dealing with the quorum needed for a meeting of directors, has been amended in two respects. One change alters the quorum requirement to a majority of the number fixed by, “or in the manner provided in,” the articles or bylaws, to conform with the amendment to article 2.32 on fixing the number of directors, just discussed.

The other purports to make clear that “the law” as well as the articles or bylaws can require a quorum to consist of more than a majority of the directors or that action taken at a meeting at which a quorum is present must be approved by more than a majority of the quorum. The purpose of adding the phrase “by law” is somewhat obscure, since it assumes there may be statutes that impose such requirements for action by the directors, somewhat similar to the approval by the holders of specified percentages of shares needed for certain corporate acts. However, the TBCA when referring to voting by the directors normally speaks only in terms of the board adopting a favorable resolution or taking other action without specifying a percentage required for such approval. The only article where the added phrase would make a difference is in article 2.36, as amended, that requires approval by a majority of the “full board” of directors when designating an
executive or other committees.\textsuperscript{389}

\textit{Meeting by Conference Telephone}. As discussed earlier,\textsuperscript{390} meetings of the board of directors may be conducted by conference telephone or similar communications techniques, or an individual director may participate in a meeting in the same manner, provided all the participants can hear one another.\textsuperscript{391} Notice requirements must still be adhered to and the articles or bylaws can restrict the use of such devices or meetings conducted in this fashion. Participation in a meeting held in this manner constitutes presence at the meeting unless it is for the purpose of objecting to the legality of the meeting’s call or convention.\textsuperscript{392} If action is taken that the director wants to disavow, he must ask that his dissent be entered in the minutes or else send it by registered mail immediately after the meeting has adjourned to the corporation’s secretary; otherwise he will be presumed to have assented.\textsuperscript{393}

\textit{Formality of Action by Directors}. One basic characteristic of American corporation law is the general authority ordinarily reposed in the board of directors to manage the business and affairs of the corporation.\textsuperscript{394} The authority is said to be one that can only be jointly exercised by the directors as a board and not as individuals.\textsuperscript{395} Moreover, the law contemplates that whatever decisions the board makes will occur during a deliberative meeting at which varying points of view can be expressed and then only after conscientious consideration has been given to the various alternatives available and judgment exercised that the best interests of the corporation and the shareholders will be served thereby.\textsuperscript{396} To that end, American corporation codes, and the TBCA is no exception, have detailed provisions dealing with such matters as the time and place of directors’ meetings; notice, quorum and voting requirements; and the manner in which the board is to be selected or re-
placed. It is not surprising therefore that sometimes transactions that have only been informally or individually approved without a meeting, even by a majority of or sometimes by all, the directors, may be successfully avoided by the corporation for want of authority of its directors to act other than as a board.

A primary difficulty with this prescribed pattern of corporate management is that it does not always fit the reality of how businessmen make decisions for their corporate entities. This is especially true in the close corporation where because of substantial identity between ownership and control the varying roles corporate law expects a shareholder, director, or officer to play tend to meld into those performed by a proprietor or partner, seen either from the standpoint of those who operate the enterprise as their own or those who deal with it. The entrepreneurs, as they regard themselves, do not require nor do they want to be bothered with the formalities of meetings and minutes, which they regard as simply a nuisance and make-work for lawyers, despite the possible risk of personal liability if the corporate entity is disregarded for such informality. At the same time, their business creditors have every reason to expect that the transactions these seeming owners have undertaken will be carried out and not sought to be avoided by sudden insistence that earlier failure to adhere to corporate niceties gives the corporation the option of nonperformance. As a result, the courts, both in recognition of the informal manner in which some corporations operate and to avoid defeating the reasonable expectations of outsiders who are unfamiliar with their internal structure and operation, have carved out various exceptions to the rule requiring formal action.

In the absence of the corporate entity, that earlier failure to adhere to corporate niceties gives the corporation the option of nonperformance. As a result, the courts, both in recognition of the informal manner in which some corporations operate and to avoid defeating the reasonable expectations of outsiders who are unfamiliar with their internal structure and operation, have carved out various exceptions to the rule requiring formal action by the directors as a board. Chief among these have been the doctrines of ratification and estoppel, especially where the corporation has been shown to have benefited from the transaction.

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402. See, e.g., 6 Z. CAVITCH, supra note 21, § 125.01, at 125-9; 2 W. FLETCHER, CYCLOPEDIA CORPORATIONS §§ 394-95, 397; 20 R. HAMILTON, TEXAS BUSINESS ORGANIZATIONS § 559, at 35; 1 HORNSTEIN 508.
or the board or the shareholders have long acquiesced in an informal pattern of management that has become the customary way of doing business,\textsuperscript{404} or else all the shareholders have given their tacit consent to an informally approved transaction.\textsuperscript{405} In addition, corporation statutes are gradually being revised to permit greater informality of operation, particularly in close corporations either by special legislation for such bodies or in dispensing with the need for formal meetings. For example, the TBCA now not only permits a close corporation to replace the board entirely if the shareholders so opt\textsuperscript{406} or agree to have the corporation operated as a partnership,\textsuperscript{407} but since 1967 has permitted the board to take action without a meeting if all the members sign a consent in writing.\textsuperscript{408}

The question of formality of action by the board of directors was recently considered by the Houston (1st District) court of civil appeals in Star Corp. v. General Screw Products Co.\textsuperscript{409} The facts are difficult to discern from the rambling opinion but in essence concerned several transactions involving a parent corporation, Star, and a wholly-owned subsidiary, G.S.P. Corporation\textsuperscript{410} (GSP) which Star formed to take over an incorporated business owned by W. A. Kenyon. Star had two shareholders, E.W. Plodzik and E.G. Ricketts, who each owned half its stock. Plodzik negotiated the acquisition with Kenyon. Under the terms, Kenyon was to receive $675,000 for the business\textsuperscript{411} to be transferred to GSP when formed, payable $150,000 in cash and the balance in secured notes. In addition, Kenyon was to be employed as GSP's president for five years. Plodzik had earlier obtained an option to buy the business. The option cost $50,000 which could be used to apply on the purchase price and was paid by Star.

\textsuperscript{404} See, e.g., Caldwell v. Kingsberry, 451 S.W.2d 247, 250 (Tex. Civ. App.—Austin 1970), error ref. n.r.e, discussed in Hamilton & Shields, supra note 400, at 104 (dictum); Dallas Ice-Factory & Cold-Storage Co. v. Crawford, 18 Tex. Civ. App. 176, 44 S.W. 875 (1898). See generally 2 W. Fletcher, Cyclopedia Corporations § 394; Lattin 248; 2 F. O'Neal, Close Corporations § 8.03, at n.4.

\textsuperscript{405} See, e.g., Aransas Pass Harbor Co. v. Manning, 94 Tex. 558, 562, 63 S.W. 627, 629 (1901); Fort Worth Publishing Co. v. Hitson, 80 Tex. 216, 228, 14 S.W. 843, 846 (1890); Sutton v. Reagan & Gee, 405 S.W.2d 828, 836 (Tex. Civ. App.—San Antonio 1966), error ref. n.r.e., discussed in Pelletier, supra note 133, at 144. See generally 20 R. Hamilton, Texas Business Organizations § 559, at 35 n.29.


\textsuperscript{409} 501 S.W.2d 374 (Tex. Civ. App.—Houston [1st Dist.] 1973), error ref. n.r.e. 410. The name of the corporation was changed to General Screw Products Company, the name of the corporation owned by Kenyon. According to the opinion this was done at a special meeting of the board of directors, id. at 376, but whether this was an authorization to initiate an amendment to the articles to change the name, Tex. Bus. Corp. Act Ann. art. 4.01(B)(1) (1956), or to file an assumed name certificate, id. art. 2.05 (B) (1955) (but cf. Tex. Rev. Civ. Stat. Ann. art. 5927a (Supp. 1974) (assumed name filing does not include corporations)), is not clear. However, since the opinion constantly refers to the subsidiary as G.S.P. Corporation, the GSP reference to it in the text seems appropriate.

\textsuperscript{411} Kenyon had two corporations, General Screw Products and Eleanor Realty Co., the latter being owned by Kenyon, his wife, and a trust for his daughter, and owned the realty on which the General Screw Products plant was located. Apparently the properties, rather than their stock, were the subject matter of the purchase agreement; otherwise there would have been no need to set up the new subsidiary to take over the properties unless they were to become its subsidiaries. 501 S.W.2d at 375.
When GSP was incorporated, Kenyon, Plodzik, and Ricketts were named as the first board of directors. According to the minutes of the organizational meeting, Star was to be issued 150,000 shares of GSP's one dollar par value stock in consideration of $150,000 to be paid in by Star; however, there was some evidence that Star had actually been issued a certificate for only 6,000 shares. Star purportedly paid for the issue with a $100,000 check and apparently that amount plus the $50,000 previously paid for the option constituted the down payment to Kenyon for the assets received by GSP. Despite the recitation in the minutes, there appears to have been an oral agreement among Plodzik, Ricketts, and a Mrs. Westbury, who was a Star director, that the $150,000 was to be regarded as an advance to GSP and would soon be repaid. This came about after Ricketts and Mrs. Westbury expressed concern that Star could not meet its obligations if that amount were paid out and Plodzik reassured them the money would "come right out of G.S.P. back to you." Later Star made other payments on the notes held by Kenyon and unquestionably did advance further funds to GSP. Ultimately, Plodzik and Ricketts seem to have divided up their investments in Star with Plodzik receiving all the shares of GSP and two other subsidiaries and Ricketts retaining all the stock in Star.

The action was brought by Ricketts as Star's sole shareholder, after it had become defunct, to recover the various sums Star had paid to GSP or to Kenyon for GSP's benefit. At the trial, the court submitted a single issue to the jury inquiring whether GSP had agreed to repay the $150,000 to Star. The jury answered in the negative, and judgment was entered for GSP.

On appeal, the Houston court reversed and remanded on the $150,000 payment, deciding after a review of the evidence that the issue answered by the jury had been improperly submitted, since if GSP was obligated to repay...

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412. The minutes also recited adoption of a resolution approving the purchase agreement between Star and the Kenyons and authorizing the issuance of $525,000 in notes as part of the agreed consideration for the purchase. There was also a consent filed in the minutes executed by Ricketts for Star as the owner of all the stock in GSP, ratifying all the actions taken by the GSP board at the organizational meeting. Id. at 376.

413. A stock certificate purporting to be Stock Certificate No. 1 for 6,000 shares was introduced in evidence; however, the stub showed that Certificate No. 1 was for 150,000 shares. Both the certificate and the stub apparently had been altered as to amount or date. Id. at 378.

414. Id. at 376.

415. When Kenyon demanded payment on the purchase money notes after default, Star executed three checks for $52,500 to him. Later Star issued another $30,000 check directly to GSP, apparently for its internal use. All the checks were drawn on an account jointly owned by Star, GSP, and several other corporations. The court ruled the trial judge should have rejected evidence that these checks were in fact charged to another company in the joint account and therefore not paid out by Star on grounds of hearsay. The defendant not having plead payment, accord and satisfaction, or any other affirmative defense, there was a sufficient basis for Star to recover these sums as a matter of law. The appellate court rendered judgment for Star for the $82,500, after severing the claim for the $150,000 advancement. Id. at 381-83.

416. Among the stipulated items of evidence was a letter agreement signed by Plodzik and addressed to Ricketts and Star, which Ricketts accepted for himself and Star, which recited that all of the shares Star owned in GSP and two other corporations had been transferred to Plodzik and that both Star and Ricketts were releasing any claims they might have had in such stocks; however, the agreement would not affect any claim either might have against Plodzik or the three corporations arising out of prior transactions or advancements between them. Id. at 377. The court had earlier stated that the action had been brought by Ricketts as the sole shareholder of Star. Id. at 375.
the advance, it was immaterial whether it had agreed to repay or not.\textsuperscript{417} Furthermore, it determined the jury's finding was against the great weight of the evidence, because there was credible evidence showing that an agreement for repayment of the $150,000 had been informally made by Ricketts and Plodzik in order to mitigate the impact of the payout on Star's financial condition. The court conceded that normally such an agreement would not be binding upon GSP since only two of the three directors acquiesced, reciting the general rule that the authority of the directors is conferred upon them only as a board and not as individuals.\textsuperscript{418} However, because Plodzik was GSP's promoter and he and Ricketts were the majority of its directors, as well as officers of both corporations, any knowledge they had of the agreement would be imputed to GSP.\textsuperscript{419} GSP's subsequent acceptance of the $100,000 paid directly to it and of the benefit received from the $50,000 paid Kenyon for the option constituted a ratification or adoption of what was essentially a promoters' agreement.\textsuperscript{420} In other words, when GSP accepted the benefits of these payments, any infirmity due to the lack of formal action by the full board was cured by ratification.

Although the Houston court's statement of the general rule requiring action by the directors as a board and the ratification exception thereto cannot be faulted, its application of these norms to the facts recited is somewhat puzzling. It was uncontroverted that a decision had been made to have a specially-formed subsidiary acquire Kenyon's business for cash and deferred payments, rather than using Star's\textsuperscript{421} or the new subsidiary's securities, and it was evident, therefore, that Star as the parent would have to provide its subsidiary with sufficient financing to make the purchase. Star's action in paying out the $150,000 was as consistent with an intent to make a long-term

\textsuperscript{417} The court reasoned the evidence showing that GSP had received $150,000 from Star would create a quasi-contractual obligation to repay that sum unless it could be shown the money was a gift or an inference drawn that it was paid to GSP as consideration for the issuance of shares. The court relied on the supreme court's holding in Ramo, Inc. v. English, 500 S.W.2d 461 (Tex. 1973), that in deciding whether advances are loans or dividends, the recipient's intent not to repay is not controlling, for if the transaction in question is a bona fide loan and there is a legal obligation to repay, the fact there was an intent not to repay would not alter its legal effect. Id. at 467.

\textsuperscript{418} The court added: "A majority of [the directors] cannot act for the board itself and bind the corporation. In order to exercise their powers they must meet so that they can hear each other's views, deliberate and then decide. They must act as an official body . . . ." 501 S.W.2d at 380.


\textsuperscript{421} If Star's stock had been used, a triangular merger might have been possible. Tex. Bus. Corp. Act Ann. arts. 5.01(B)(4), 5.02(B)(4) (Supp. 1974), discussed in Lebowitz, supra note 131, at 99-111.
investment in its subsidiary in exchange for the stock that would give it ownership as it was with an inferred agreement that these sums were to be repaid as advances, especially since there was no evidence to show any other consideration had been paid for the issuance of GSP's stock. The notion of setting up a subsidiary by furnishing it with funds through payment for its shares to acquire some assets and then immediately withdrawing those funds and leaving the subsidiary in an undercapitalized position is reminiscent of a practice sometimes followed under the old corporation law. Under this practice money would be borrowed from a bank on a short-term loan to pay for the amount of stock required to be paid in for stock subscriptions before corporate existence could begin, and as soon as the charter was filed the funds would be withdrawn to repay the bank.

In essence, Star received equivalency for the money it paid to and for GSP through the enhanced value of the GSP stock it owned as represented by the net worth of the business and assets the subsidiary was taking over, even though admittedly the payout could well have adversely affected Star's working capital position. Surely someone was expected to pay Kenyon for his business; and since Star owned all of GSP's stock, it got what it paid for when GSP received the assets with the money Star invested in it. To say, as the court did, that by using the proceeds to acquire the very business for which it had been created, and without any showing there had been any other payment for its shares, GSP ratified an oral understanding by two of its directors that the sums would be repaid, seems not only to be using bootstrap logic but overlooks the evidence, including the corporate minutes, that supported the contrary inference drawn by the jury in its finding. At a minimum

422. Based on the facts given, it is difficult to understand why there was not enough probative evidence to support the jury's finding or at least to hold it was not against the great weight and preponderance of the evidence as to be wrong and unjust, as the court ruled. The minutes recited that the shares were to be issued for $150,000; the stub in the stock book showed a certificate for that amount had been issued. Kenyon testified that he saw such a certificate and that all the papers that were signed at the meeting, which had been prepared in advance by lawyers, had been read aloud at the meeting, and no one had protested. On the other hand, there was no direct evidence of an agreement to repay other than the concern expressed by Ricketts and Mrs. Westbury and Plodzik's reassurance to them; as the court itself suggested, Kenyon would probably not have agreed to repayment out of the funds of the business being acquired by GSP. Almost inexplicably, the court states there was no evidence that the stock had a par value and that the announcement concerning the stock subscription did not specify the consideration paid. 501 S.W.2d at 380. Yet the resolution contained in the minutes recited both the par value of the stock and the total consideration for which such shares were to be issued. Id. at 376. Moreover, the stock certificate for 6,000 shares introduced in evidence must have shown whether the stock had a par value or not. Certainly the minutes were at least prima facie evidence of the action taken by GSP at the organizational meeting, and surely testimony of a more conclusive nature should have been offered to overcome the effect of their recitation here. See, e.g., Mcllhenny v. Binz, 80 Tex. 1, 9, 13 S.W. 655, 658 (1890), error dismissed sub nom. Houston, E. & W.T. Ry. v. Binz, 145 U.S. 641 (1892), and sub nom. Union Trust Co. v. Binz, 145 U.S. 657 (1892).

423. Under the pre-TBCA statutory law, a Texas corporation having par value stock was required to have all of the stock subscribed for and 50% paid in cash or its equivalent in other property or labor done before the charter could be filed by the secretary of state. Ch. 166, § 1, [1907] Tex. Laws 309 (codified as Tex. Rev. Civ. Stat. Ann. art. 1308 (1926)), repealed by ch. 229, § 1, [1961] Tex. Laws 458; see 1 1. HILDEBRAND, TEXAS CORPORATIONS 64.


425. See note 422 supra.
mum the repayment decision was one that should have been made by the full board. But perhaps the court felt the need of using the ratification exception to the general rules as a means of adjusting the equities between Ricketts and Plodzik upon the division of their companies among themselves, since apparently Plodzik ended up with the operating subsidiaries and Ricketts was ultimately left with the defunct parent. If so, it would not be the first time doctrine has been loosely employed to reach a right result.

Removal of Directors. Prior to adoption of the TBCA, the Texas law was silent on the power of the shareholders to remove a director from office until his term had expired,426 although case law elsewhere held the shareholders had an inherent power to remove for cause.427 But they had no power to remove without cause unless granted by statute or reserved in the articles or bylaws.428 Article 2.32 of the TBCA as originally enacted stated that a director once elected held office for the term for which he was elected and until his successor had been elected and qualified “unless removed in accordance with the provisions of the bylaws.”429 Whether the bylaws could provide for removal with or without cause was not indicated; however, the Bar Committee comment suggested they could.430 Moreover, in Textile, Inc. v. Wineburgh,431 the only Texas decision to have directly considered the removal power since the TBCA was adopted, the court held that there was at least power to remove a director who was not a shareholder at the time, with or without cause, if all the shareholders approved. On the other hand, even though the removed director would not have standing to complain,432 a minority shareholder or possibly creditors would have such standing if the

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428. See, e.g., Toledo Traction Light & Power Co. v. Smith, 205 F. 643 (N.Ohio 1913); Walsh v. State ex rel. Cook, 199 Ala. 486, 74 So. 45 (1917); People ex rel. Manice v. Powell, 201 N.Y. 194, 94 N.E. 634 (1911); Abberger v. Kulp, 156 Misc. 210, 281 N.Y.S. 373 (Sup. Ct. 1935). See generally 2 W. FLETCHER, CYCLOPEDIA CORPORATIONS § 352; Travers, supra note 427, at 389.

429. Ch. 64, art. 2.32, [1956] Tex. Laws 239.

430. The comment suggested that “[t]he bylaws may, for example, provide for such removal without cause.” Comment of Bar Committee to Art. 2.32, 3A TEX. REV. CIV. STAT. ANN. 128 (1956).

431. 373 S.W.2d 325 (Tex. Civ. App.—Dallas 1963), error ref. n.r.e.

432. Both Professors Hamilton and Travers are critical of this aspect of the holding. Professor Hamilton thinks that since it was not certain whether there were bylaws authorizing removal without cause, the director may have had an independent interest in his position if for no other purpose than representing possible future creditors. 19 R. HAMILTON, TEXAS BUSINESS ORGANIZATIONS § 495, at 525. He is also critical of the opinion because it seems to disenfranchise the record owner of shares, despite TBCA art. 2.27(A), by allowing the beneficial owners to call a shareholders' meeting without notice and oust the record owner from office as a director. Id. § 443, at 486 n.23. Professor Travers notes that the Textile decision seems contrary to the bulk of decisions that assume the director has standing to sue and that he has a vested right in his position. Travers, supra note 427, at 401. Both, however, are sympathetic with the result reached.
majority removed a director without cause, presumably absent a bylaw authorizing the same.

Part of the 1973 amendment to article 2.32 finally makes clear that removal can be without cause as well as for cause if so provided in the articles of incorporation or the bylaws.\textsuperscript{438} The specification of the articles as a source for the conferral of the power is new, although a removal provision undoubtedly could have been made part of the articles before.\textsuperscript{434} Removal of a director must be approved by the vote of the holders of a majority of shares entitled to vote for directors at a meeting expressly called for that purpose, subject to any further restriction on removal "contained in the bylaws."\textsuperscript{435} Failure to mention the articles as another source for additional restrictions was probably inadvertent; as just indicated, such restrictions can be included in the articles anyway. In fact, if one of the restrictions is a requirement for greater than a majority vote, it may be necessary to put such requirement in the articles to comply with article 9.08.\textsuperscript{436} Finally, as previously discussed,\textsuperscript{437} the removal power is limited if cumulative voting is available in that a director elected by cumulative voting cannot be removed if the votes cast against his removal would have elected him through such voting at an election for the entire board or of the class of directors of which he is a part, unless the entire board of directors is being removed.

Even though the amendment further illuminates the Texas law on removal, there remain some aspects that will need future resolution. What constitutes cause for removal, for example, is a matter that will have to be developed on a case-by-case basis.\textsuperscript{438} The law elsewhere is that a director sought to be removed for cause has a right to notice of the charges against him and must be afforded an opportunity to defend himself, either in proxy solicitation...
tions to the shareholders or otherwise;\textsuperscript{439} the amendment is silent on this. Neither does it indicate whether a court has power to remove a director for cause,\textsuperscript{440} which a few states permit by statute,\textsuperscript{441} although once removal has occurred there clearly is a power of judicial review,\textsuperscript{442} provided the plaintiff has standing to complain.\textsuperscript{443} Finally, it is not certain whether adoption of an amendment to the articles or bylaws empowering removal for cause or not allows the shareholders to remove directors in office at the time the amendment was adopted. There is some authority suggesting they may not,\textsuperscript{444} but given the explicit language in amended article 2.32, the right to remain in office as a director should be regarded as conditioned on possible adoption of such a provision.

\textsuperscript{439} See, e.g., Campbell v. Loew's Inc., 36 Del. Ch. 563, 134 A.2d 852 (1957); Alliance Co-op Ins. Co. v. Gasche, 93 Kan. 147, 142 P. 882 (1914); Auer v. Dressel, 306 N.Y. 427, 118 N.E.2d 590 (1954); cf. Tex. Rev. Civ. Stat. Ann. art. 5751 (1958), dealing with removal of officers and directors of marketing associations. Under that statute 10% of the membership must petition for removal; the director or officer against whom charges are brought must be informed of them in writing; he must have an opportunity to be heard in person or by counsel and to present witnesses at the meeting called for removal. See Been v. Producers Ass'n of San Antonio, Inc., 352 S.W.2d 292 (Tex. Civ. App.—San Antonio 1961), striking down a bylaw purporting to allow removal of a director or officer without cause, charges, notice, or hearing as being in conflict with the statute. See generally Cary 135; 2 W. Fletcher, Cyclopaedia Corporations § 354, at 159; 20 R. Hamilton, Texas Business Organizations § 555, at 32; 1 Hornstein 501; Travers, supra note 427, at 415.

\textsuperscript{440} The traditional view is that a court of equity has no power to remove a director, even for cause. See, e.g., Feldman v. Pennroad Corp., 60 F. Supp. 716 (D. Del. 1945), aff'd, 155 F.2d 773 (3d Cir. 1946), cert. denied, 329 U.S. 808 (1947); Tri-City Elec. Serv. Co. v. Jarvis, 206 Ind. 5, 185 N.E. 136 (1933); Markovitz v. Markovitz, 336 Pa. 145, 8 A.2d 46 (1939); cf. Application of Burkin, 1 N.Y.2d 570, 136 N.E.2d 862, 154 N.Y.S.2d 898 (1956). But see Brown v. North Ventura Road Dev. Co., 216 Cal. App. 2d 227, 30 Cal. Rptr. 568 (1963) (since director is in position of trust, judicial power to remove exists independent of statute). See generally 6 Z. Cavit, supra note 21, § 124.05[1], at 917; 2 W. Fletcher, Cyclopaedia Corporations § 358. In Texas, if directors have been guilty of oppressive, fraudulent conduct, they may in effect be removed from management by appointment of a receiver to rehabilitate the corporation. Tex. Bus. Corp. Act Ann. art. 7.05(A)(1)(c) (1956). See also Comment of Bar Committee to Art. 2.32, 3A Tex. Rev. Civ. Stat. Ann. 128 (1956), referring to the power of removal as "cumulative of such action by a court order."

\textsuperscript{441} E.g., Cal. Corp. Code Ann. § 811 (West 1955) (holders of 10% or more of shares may petition court for removal); Me. Rev. Stat. Ann. tit. 13-A, § 707.6 (1964) (two-thirds of directors then in office may petition); N.Y. Bus. Corp. Law § 706(d) (McKinney 1963) (holders of 10% of shares or attorney general); N.C. Gen. Stat. § 55-27(g) (1965) (holders of 5% of shares); Pa. Stat. Ann. tit. 15, § 1405C (1967) (holders of 10% of shares); R.I. Gen. Laws Ann. § 7-1.1-36.1(d) (1969) (holders of 10% of shares); S.C. Code Ann. § 12-18.7(d) (Supp. 1973) (holders of 5% of shares). Most of the statutes state as cause of removal, fraud, dishonesty, or gross abuse of authority or discretion. See generally 6 Z. Cavit, supra note 21, § 124.05(3); 2 W. Fletcher, Cyclopaedia Corporations § 358, at 172-73; 1 Hornstein § 391.

\textsuperscript{442} See, e.g., 2 W. Fletcher, Cyclopaedia Corporations § 360; 1 Hornstein 501; Travers, supra note 427, at 417.

\textsuperscript{443} See 2 W. Fletcher, Cyclopaedia Corporations § 359. See also note 432 supra.

\textsuperscript{444} See, e.g., Toledo Traction Light & Power Co. v. Smith, 205 F. 643 (N.D. Ohio 1913); Frank v. Anthony, 107 So. 2d 136 (Fla. App. 1958); People ex rel. Manice v. Powell, 201 N.Y. 194, 94 N.E. 634 (1911); Abberger v. Kulp, 156 Misc. 210, 281 N.Y.S. 373 (Sup. Ct. 1935); cf. Essential Enterprises Corp. v. Automatic Steel Prods., Inc., 159 A.2d 288 (Del. Ch. 1960); Cuppy v. Stoffweerk Bros., 216 N.Y. 591, 111 N.E. 249 (1916). See generally 6 Z. Cavit, supra note 21, § 124.05[2], at 919; 2 W. Fletcher, Cyclopaedia Corporations § 354, at 157. Professor Hamilton raises another issue as to whether shareholders may amend the bylaws to allow removal of a director and then remove one or more directors at the same meeting. He notes that article 2.32 requires a meeting "expressly" called for the purpose and seems to assume a bylaw already exists that authorizes such call. 19 R. Hamilton, Texas Business Organizations § 495, at 33 n.34 (Supp. 1974).
Despite these unanswered questions, the more detailed exposition of the shareholders' power of removal made by the amendment should prove helpful if serious thought is given to its potential exercise in corporate planning. A broad removal provision will aid majority shareholders desiring to oust a recalcitrant director whose business policies they want to change, or whose conduct is suspect but difficult to prove, or, in cases of a takeover, when old management resists to the very end. On the other hand, participants in a close corporation who desire to protect their individual status as directors may well want to exclude the power entirely or subject its exercise to a veto through high voting requirements.\textsuperscript{445}

Delegation of Authority to Executive or Other Committees. Publicly-held corporations very often have several or, sometimes, a majority of so-called "outside" directors sitting on their boards. Generally these directors are not actively involved in day-to-day management, but are expected instead to attend regular or special meetings of the board, when called, to decide on basic corporate policies. Because it may not always be convenient to convene such a board when a matter arises that necessitates action by all the directors, it has become fairly common to establish an executive committee composed of a few members who can act for the board in the interim between meetings, and to whom some or most of the board's powers can be delegated. In addition, large boards of directors can frequently work more effectively if divided into special committees to supervise or to advise on such matters as finance, executive compensation plans, shareholder relations, or operations of particular divisions or groupings of affiliated or subsidiary companies.

The common law has long recognized the need for such delegation to or division of power among board committees, although at one time there was a fine line drawn between ministerial acts which were deemed delegable, and discretionary acts which were not, assuming there had been no abdication of power completely to one or more directors or outsiders,\textsuperscript{446} and today virtually every corporation code specifically sanctions the creation of at least an executive committee.\textsuperscript{447} Implicit in such recognition, however, and often explicitly stated in the statutes, is the rule that despite such delegation the board as a whole or the directors individually must continue to bear the responsibilities imposed on them by law.\textsuperscript{448}


\textsuperscript{447} Arizona is the only state with no statute on corporate committees. ABA MODEL BUS. CORP. ACT 2d, § 42, ¶ 3.04. See generally FOLK, \textit{supra} note 12, at 899.

\textsuperscript{448} The Model Act language is typical: "The designation of any such committee and the delegation thereto of authority shall not operate to relive the board of directors,
In Texas, the development of the law relating to the board's power to delegate authority to an executive or other committees has followed somewhat the same pattern. While a few cases cast some doubt on the degree to which total authority could be delegated, a Texas Supreme Court case reaffirmed the board's power to delegate either to subordinate officers or agents or to a committee of their own number authority to perform any act, "although the performance of the act may involve the exercise of the highest judgment and discretion." The TBCA, on the other hand, did not go quite that far when first enacted. Under article 2.36, if the articles or bylaws so provided, the board could designate two or more directors to serve as an executive committee that could, to the extent allowed by the resolution creating it or the articles or bylaws, exercise all the managerial authority of the board "except where action of the board of directors is specified by this Act or other applicable law," but such designation or delegation would not relieve the directors as a whole or individually of their legal responsibilities. The provision did not mention delegation to other committees, although the original Bar Committee comment suggested any power that could be delegated to an officer "may of course" be delegated to the executive committee "or to any other Committee of the Board."

The 1973 amendment to article 2.36 has expanded the original statutory authorization, but not to the extent permitted by pre-TBCA case law.

or any member thereof, of any responsibility imposed by law.” ABA Model Bus. Corp. Act Ann. 2d, § 42.


451. 129 Tex. at 342, 105 S.W.2d at 654.


455. The reference to a majority of "the full board of directors" considerably shortens the language in the former provision that spoke of action by a majority of the number of directors fixed by the bylaws, or in the absence of a bylaw fixing the number of directors, a majority of the number stated in the articles of incorporation. Ch. 64, art. 2.36, [1955] Tex. Laws 239, as amended, Tex. Bus. Corp. Act Ann. art. 2.36 (Supp. 1974).
functions, within limits set by the resolution or the articles or bylaws, except as to certain specified matters for which authority cannot be delegated. Those actions which will continue to require consideration and approval by all the directors are those relating to: (1) amendments of the articles; (2) merger, consolidation, or sale of all or substantially all the assets not in the regular course of business; (3) voluntary dissolution; (4) alteration, repeal or adoption of bylaws; (5) filling vacancies in or "removing members of the board of directors"\(^{456}\) or any such committee; (6) fixing compensation for such committee members; or (7) alteration or repeal of any board resolution stating it is not to be amended or repealed. In addition, unless the resolution, articles, or bylaws expressly so provide, a committee cannot declare dividends or authorize the issuance of shares. Obviously, this listing is less encompassing than the former, more general language that precluded delegation as to any matter where the TBCA or other law specified action by the board.\(^{457}\) This means that if authority has been properly delegated the executive or some other committee may authorize the repurchase of shares to the extent of unrestricted earned surplus,\(^{458}\) call for payment of stock subscriptions,\(^{459}\) make distributions in partial liquidation\(^{460}\) or to discharge cumulative dividend rights,\(^{461}\) elect or remove officers,\(^{462}\) call shares for redemption,\(^{463}\) reduce stated capital after the redemption or repurchase of redeemable shares,\(^{464}\) cancel treasury shares,\(^{465}\) recommend reduction of stated capital represented by no par shares,\(^{466}\) apply capital or reduction surplus to reduce or eliminate deficits in the earned surplus account,\(^{467}\) create or abolish reserves out of earned

\(^{456}\) This suggests the board has power to remove one or more of its own members and to fill all vacancies on the board. However, article 2.32 as amended makes quite evident the shareholders alone have the removal power. See discussion in text accompanying notes 426-45 supra. See generally ABA MODEL BUS. CORP. ACT ANN. 2d, § 39, ¶ 4.02; W. FLETCHER, CYCLOPEDIA CORPORATIONS § 357. Although vacancies on the board can be filled by the vote of the remaining directors, any new directorships caused by enlarging the number of directors must be filled by action of the shareholders at the general meeting or at a special meeting called for that purpose. TEX. BUS. CORP. ACT ANN. art. 2.34 (1956). Perhaps the draftsmen intended to refer to removal of officers, a power which is vested in the board. Id. art. 2.43 (1956). Neither the Model Act nor the Delaware statute, the two sources for the amendment, see note 454 supra, specifies removal of directors (or for that matter, of officers) as matters reserved for action by the full board.

\(^{457}\) Ch. 64, art. 2.36, [1955] Tex. Laws 239, as amended, TEX. BUS. CORP. ACT ANN. art. 2.36 (Supp. 1974). In a sense, the general language used was almost self-defeating, since among the provisions of the Act "where action of the board of directors is specified" is article 2.31, stating that the business and affairs of the corporation "shall be managed by a board of directors." This would suggest it would be improper to delegate any managerial authority to the executive committee which of course is contrary to what article 2.36 states. See Lebowitz, Duties and Liabilities of Directors, in TEXAS BUSINESS CORPORATION ACT PROCEEDINGS 74 (1955), reprinted in 3A TEX. REV. CIV. STAT. ANN. 506 (1956).

\(^{458}\) TEX. BUS. CORP. ACT ANN. art. 2.03(C) (1956).

\(^{459}\) Id. art. 2.14(D).

\(^{460}\) Id. art. 2.40(A).

\(^{461}\) Id. art. 2.40(B).

\(^{462}\) Id. arts. 2.42, 2.43.

\(^{463}\) Id. art. 4.08(A).

\(^{464}\) Id. art. 4.10(A).

\(^{465}\) Id. art. 4.11(A).

\(^{466}\) Id. art. 4.12(A)(1).

\(^{467}\) Id. art. 4.13(B).
surplus, or authorize conveyances of corporate property. In view of the broad range of these delegable actions, serious consideration should be given when drafting articles, bylaws, or resolutions setting up any of these committees as to whether some of the matters just specified ought not to be reserved for approval by the full board.

While the amendment does not specifically say so, a committee can presumably be composed of a single director. Also, as noted before, another amendment allows members of such committees to hold or participate in meetings by means of conference telephone or similar communications equipment.

C. Action by Officers

While none of the 1973 TBCA amendments deal directly with the function of officers or other supervisory employees in the conduct of corporate affairs, the new Penal Code contains several relevant provisions. For example, as discussed earlier, the extent and degree of corporate criminal responsibility imposed by the Code will depend on whether the conduct constituting the offense was committed by a director, officer, employee, or other agent acting in behalf of the corporation and within the scope of his office or employment, or else was sanctioned by a majority of the board or by an officer or other high managerial agent acting in the corporation's behalf and within the scope of office. There were also a few cases that considered various actions undertaken by officers or other members of management while purportedly representing their corporations, but none were of great significance.

The most noteworthy case of the group concerned the power of the vice-president to act in the place of the president in taking a vote of the board of directors on, and later executing, a conveyance of some of the corporation's property, even though the president was present at the meeting. The corporation was essentially an incorporated recreation club that had been formed for the benefit of property owners of a lakeshore subdivision. A minority group of member-stockholders objected to a lease of the club property that had been made by the president without board approval to one of the members. Under the lease's terms, the lessee could op-

468. Id. art. 4.13(C).
469. Id. art. 5.08.
470. Before its amendment, article 2.36 stated that the board could designate "two or more directors" to constitute the executive committee (emphasis added). As amended, it provides the board may designate an executive and one or more committees "from among its members." The Bar Committee comment that states "additionally, the required number of a committee of the board of directors has been reduced from three to one" is obviously in error. See Comment of Bar Committee to Art. 2.36, 3A Tex. Rev. Civ. Stat. Ann. 91 (Supp. 1974) (emphasis added). A few state statutes say specifically committees may be composed of one or more members. See, e.g., Nev. Rev. Stat. § 78.125 (1970); N.J. Stat. Ann. § 14A:6-9 (Supp. 1973).
471. See discussion in text accompanying notes 199-205 supra.
erate the facilities as a private club to which the property owners would have to pay new dues. He was also given the right under the lease to erect a fence around the premises that would enclose part of the lot through which the property owners had access to the lake by virtue of an easement of ingress and egress granted by the subdivision's developers. A special meeting of the board was called at which more directors representing the minority faction were present than the majority's. A minority director proposed giving a quitclaim deed to that part of the lot providing access to the lake to certain named trustees for the benefit of all present and future lot owners in the subdivision. When the president refused to call a vote on the motion, saying he wanted to obtain the advice of counsel, the vice president took over and the resolution was passed by a three-to-two vote.475 The vice president then executed the quitclaim deed to the trustees who had it recorded the next day. Less than two months later, the board met again, voted to rescind the quitclaim deed and declare it void \textit{ab initio},476 and brought an action for a declaratory judgment and to quiet title. The trial court, however, gave judgment to the trustees, based on favorable jury findings.

The Austin court of civil appeals affirmed on several grounds.477 On the issue of whether the vice president was authorized to act, the court simply noted that the corporation's bylaws provided that the vice president could perform the duties of the president either in his absence or in the event of his inability "or refusal to act;"478 hence when the president would not call the vote, whatever his motive, the vice president properly assumed the chair for the vote, and his execution of the deed bound the club.

Under the TBCA, a vice president may execute a number of corporate documents in lieu of the president,479 including conveyances of the corporation's property.480 But while there is a presumption of authority when the vice president acts in place of the president,481 the determination of

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475. At the time the minority faction had control of the board by a 4-3 margin. One board member was absent, 493 S.W.2d at 346; presumably he was a majority shareholder representative and the vice president must not have voted as presiding officer. \textit{See note 476 infra.}

476. The special meeting was held seven days before the annual stockholders' meeting at which the majority shareholders regained control of the board and a resolution was passed authorizing the directors to take whatever steps were necessary to prevent the quitclaim deed from clouding the corporation's title to its property. These facts do not appear in the opinion, but are taken from undated letters from the majority and minority shareholders soliciting proxies for the annual meeting of June 24, 1972, which are in the author's files. At an earlier period, the author was asked to redraft the corporation's bylaws when it was discovered that although organized as a stock corporation under the TBCA, it had been operating under bylaws for a non-profit recreational club. Somehow in the process the author ended up with a share of the corporation's stock and thus has become a bemused observer of the shifting struggles for control each year.

477. The court ruled the quitclaim deed created an irrevocable trust, had been given for valid consideration and was properly delivered, and that the trial court had not erred in amending the property description in its judgment (so as to exclude the clubhouse site). Based on the defendants' counterclaim, the court also affirmed the cancellation of shares that had been issued to some of the majority shareholders.

478. 493 S.W.2d at 348.

479. \textit{See, e.g., Tex. Bus. Corp. Act Ann. arts. 4.04(A) (articles of amendment), 4.11(B) (statement of cancellation of treasury shares), 5.04(A) (articles of merger or consolidation of domestic corporations), 6.06(A) (articles of dissolution) (1956).}

480. \textit{Id. art. 5.08 (1956).}

481. \textit{E.g., Ballard v. Carmichael, 83 Tex. 355, 367, 18 S.W. 734, 739 (1892); Huf-
whether there is actual authority for his action must depend upon its source, since there is no presumption of authority by virtue of his office alone.\textsuperscript{482} Here the vice president had been authorized by a majority of the board, albeit a temporary one, to execute the quitclaim deed. Furthermore, even though a vice president normally is not expected to perform the president's function except when the latter is absent, disabled or has vacated his office,\textsuperscript{488} or some of the president's duties have been properly delegated to him, the fact remained that the corporation's bylaw did specifically state he could take the president's place if that official refused to act.\textsuperscript{484} Actually, the bylaw in question is a fairly standard one;\textsuperscript{488} perhaps in light of the decision some additional thought should be given to the desirability of including the refusal to act contingency if factional disputes among board members or officers can be anticipated.

Two cases of interest were brief opinions by the United States Court of Appeals for the Fifth Circuit applying Texas law. In one,\textsuperscript{488} the appellate court affirmed the trial court's judgment that a corporation was not responsible to a discharged employee for an allegedly slanderous statement made by the corporation's warehouse superintendent to a union steward that the plaintiff had been discharged for theft. The plaintiff had the burden of showing the slander was uttered by the superintendent in the discharge of a corporate duty\textsuperscript{487} and since the jury found the superintendent had no such duty, his statement was not legally attributable to the corporation. The other case\textsuperscript{488} was a per curiam opinion sustaining the award of a judgment in a breach of contract action against the plaintiff notwithstanding a verdict in his favor, the court holding an individual director had no authority to bind his corporation to a contract to purchase the plaintiff's business.\textsuperscript{489} Moreover, being an oral contract, it was unenforceable under the Uniform Commercial Code.

One other case by the Amarillo court of civil appeals, \textit{Maxey v. Citizens National Bank},\textsuperscript{490} ruled that a bank could not be held liable for con-
version by fraud and conspiracy of a customer-borrower's property resulting from his dealings with the bank, when in earlier judgments, all of the bank's representatives had been exculpated for their actions in behalf of the bank in the transactions complained of. The court acknowledged that a bank can be held liable for conversion along with its officials and representatives as joint tortfeasors; however, its liability in such cases is not primary, but rather is derived from the acts of those who represent it. However, during the writing of this survey article, the Amarillo court's decision was reversed. The 1975 survey will discuss the supreme court's holding in more detail, but in short the high court ruled that it was error to have granted summary judgment in the bank's favor on the basis of the earlier judgments for its representatives. As a party to security agreements with the plaintiff customer-borrower, the bank assumed primary duties to exercise good faith and fairness in the sale of collateral, apart from any duties owed the plaintiff by its officials or representatives, and thus plaintiff's claim against the bank was not barred by res judicata or estoppel by judgment.

D. Corporate Records

A Texas corporation is required to keep books of account, minutes of shareholders' and directors' meetings, and a record of its shareholders, addresses, and their holdings. In addition, the officer and agent in charge of the stock transfer books must prepare a list of shareholders eligible to vote at least ten days before a shareholders' meeting. Other than the requirement that the books and records of account be correct and complete, not much is said in the statute as to the form in which such records should appear. For example, if the directors or shareholders take action without a meeting by executing a written consent, presumably such consents when filed somewhere in the corporate records will be deemed equivalent to minutes. But whatever the format, the law has assumed it would be in writing, if for no other reason than to become available for inspection by shareholders making proper demand therefor.

In recent years rapid developments in communications and computer technology have led to the practice, particularly in larger corporations, of keeping books and records in other than written form, generally utilizing various information storage and retrieval systems. Tape recorders, for example, are frequently used to more accurately preserve proceedings at stockholders', directors', or committee meetings for later transcription if the need should arise. To accommodate employment of these new

494. Id. art. 2.27 (1956).
495. Id. art. 9.10(A), (B) (Supp. 1974).
496. See 19 R. Hamilton, Texas Business Organizations § 453, at 500 n.65.
497. 20 id. § 804, at 335.
498. This assumes good equipment has been used, no gaps appear in the transcription,
techniques for storing financial and other data, the TBCA has been amended to allow books, records, and minutes either to be in written form or in any other form capable of being converted into writing within a reasonable time.\(^4\) In keeping with its Model Act source,\(^5\) the amendment does not attempt to specify or anticipate the variety of forms, "from microfilm to electronic tapes to memory banks,"\(^6\) that may be used. The important criterion is that the information be reducible or convertible into written form; otherwise the shareholder's right of inspection can easily be frustrated.\(^7\)

Another amendment to the same article,\(^8\) also taken from the Model Act, is designed to provide a shareholder with at least some basic financial data about his corporation without having to resort to formal inspection or litigation to get it.\(^9\) Upon written request, a shareholder of record (which includes the holder of a beneficial interest in a voting trust)\(^10\) can have the corporation mail to him within a reasonable time its last annual fiscal statements if reasonably detailed and a report of its operations, along with the most recent interim statements, if any, that have been publicly filed or otherwise published.\(^11\) This is in addition to the obligation imposed on the board of directors to provide similar information upon request by the holders of at least one-third of the outstanding shares.\(^12\) It may seem surprising at this late date to have an amendment requiring information be furnished a stockholder on his request since the receipt of annual reports and proxy statements has become commonplace for most investors. Yet such reporting has come about largely as the result of federal law,\(^13\)

\(^{5}\) ABA Model Bus. Corp. Act Ann. 2d, § 52.
\(^{6}\) Id. ¶ 2.
\(^{7}\) Id.
\(^{9}\) The shareholder's right of inspection of corporate records is dealt with in other sections of article 2.44 that were also amended. See discussion in text accompanying notes 619-36 infra.
\(^{11}\) Professor Hamilton notes that grammatically it is not clear whether the annual statements and report, as well as the interim reports, must have been filed in a public record or otherwise published. 20 R. Hamilton, Texas Business Corporations § 802 (Supp. 1974). As he correctly surmises, the intent was to include interim reports that were readily available such as those taken from forms 10-Q, filed under §§ 13 or 15(d) of the Securities Exchange Act, 15 U.S.C. §§ 78m, 78o(d) (1970) pursuant to rules 13a-13 or 15d-13, 17 C.F.R. §§ 240.13a-13, 240.15d-13, 249.308a (1973), or found in various securities manuals, and not to limit the annual reports to be sent on request to those previously filed or published. The Model Act does not contain the interim report requirement. Apparently New York is the only other state that does. ABA Model Bus. Corp. Act Ann. 2d, § 52, Last Para., ¶¶ 3.01-03. However, New York limits the information furnished the shareholder on request to the last annual balance sheet and profit and loss statement plus any interim statements that have been distributed to the shareholders or otherwise made available to the public; moreover, the requesting shareholder must have been a holder of record for six months or own 5% of the outstanding shares of the corporation. N.Y. Bus. Corp. Law § 624(e) (McKinney 1963).
\(^{13}\) Under the Securities Exchange Act of 1934, issuers whose securities are listed on a national securities exchange, or which have total assets exceeding $1,000,000 and 500 holders or more of a class of equity securities (not otherwise exempt), or which
not state corporation statutes.\textsuperscript{509} Despite the very fundamental nature of the shareholder's right to know about his corporation's affairs, it is only comparatively recently that some states have begun implementing that right beyond permitting physical examination of the records. And even now, as the Texas and Model Act provisions indicate, the shareholder must still take the initiative if his corporation is not one required to communicate with him under the federal law.\textsuperscript{510} Thus far only a handful of states command their corporations to furnish stockholders with even rudimentary reports on a periodic basis.\textsuperscript{511} Granted that some corporations do send reports to their shareholders annually without compulsion, perhaps to foster good shareholder relations or because of a perceived moral imperative that it is only right that shareholders be informed, there still seems little reason why any corporation having public or inactive shareholders should not be required to fulfill this responsibility.

III. The Close Corporation

A. Legislative Developments

Perhaps the most extensive changes the 1973 amendments made in Texas corporate law were those affecting the close corporation. For the first time, these entities have been singled out for special statutory treatment and are granted privileges of corporate government and arrangement of relations among their shareholders not afforded other corporations or shareholders. Because they depart so far from the usual corporate norms in many respects, the new close corporation statutes deserve more extended consideration than can be given in a survey article such as this\textsuperscript{512} and as a

\textsuperscript{509} See, e.g., CARY 1029; 2 L. Loss, supra note 66, at 1149; Knauss, A Reappraisal of the Role of Disclosure, 62 Mich. L. Rev. 607, 625 (1964); Sommers, supra note 508, at 1094.


\textsuperscript{511} CAL. CORP. CODE § 3006 (West 1955); CONN. GEN. STAT. REV. § 33-334(a) (Supp. 1973); MICH. COMP. LAWS § 450.1901 (1973); OKLA. STAT. ANN. tit. 18, § 1.72 (1953); PA. STAT. ANN. tit. 15, § 1318 (1967).

\textsuperscript{512} Several useful summaries of the new close corporation statutes have already appeared. The most detailed is a helpful comparative study by William P. Bivins, Jr.; see Comment, The New Texas Close Corporation Legislation: A Comparison with Florida and Delaware, 27 Sw. L.J. 340 (1973). Professor Hamilton has written a succinct yet critical analysis as part of the 1974 pocket part supplementation to his excellent treatise; see 20 R. HAMILTON, TEXAS BUSINESS ORGANIZATIONS §§ 661, 670, 673, 674, 676, 696-702 (Supp. 1974). Further insight into the purposes of the legislation can be found in
consequence this author is preparing a separate article that will deal with these new provisions in much more detail. All that will be undertaken here is a brief synopsis of their content plus mention of several other amendments affecting all corporations that can also be used in close corporation situations.

**Basic Pattern of Legislative Changes.** The 1973 amendments affecting the close corporation fall into two categories. The first consists of an integrated set of new statutes and amendments that pertain only to those corporations that meet the following definition of a close corporation: a domestic corporation composed of no more than fifteen shareholders of record whose shares were privately issued and are subject to some restriction on transferability.518 Such corporations are referred to hereafter as defined closed corporations. The second group encompasses the changes made in other laws that apply overtly to all corporations but nevertheless have particular utility for close corporations, whether of the defined category or not. The most significant in this group is the amendment virtually rewriting article 2.22, dealing with stock transfer restrictions.614 In addition, there re-

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513. **TEX. BUS. CORP. ACT ANN.** art. 2.30-1(A) (Supp. 1974). As indicated, there are three elements to the definition. First the corporation must be one "which, at any given time, has no more than 15 shareholders of record of all classes of shares, whether or not entitled to vote." Fifteen was set as the maximum number in the belief that any number in excess of that figure would make management by the shareholders cumbersome; also 15 is one of the benchmarks of a private offering in the Texas Securities Act, **TEX. REV. CIV. STAT. ANN.** art. 581-5, subsec. 1(c) (1964). Comment of Bar Committee to Art. 2.30-1, 3A **TEX. REV. CIV. STAT. ANN.** 76, 77 (Supp. 1974). In addition, in counting to 15, shares held by husband and wife either as community property or as joint tenants or tenants by the entirety, or by a decedent's or incompetent's estate, or by an express trust, partnership, or corporation (if none of those entities were formed for the primary purpose of holding shares in the close corporation) are treated as if held by a single shareholder. The specification is derived from the State Securities Board's interpretation of section 5.1. Note how security holders are to be counted for purposes of that exemption. **Texas Securities Board Policies & Interpretations No. 7,** at I-A(10) (Sept. 18, 1970), 3 CCH **BLUE SKY L. REP.** ¶ 46,650 (1972). See generally Bromberg, **Texas Exemptions for Small Offerings of Corporate Securities,** 18 **SW. L.J.** 537, 539 (1964); Lebowitz, supra note 131, at 138.

Secondly, the corporation's "issued shares of all classes shall be subject to one or more of the restrictions on transfer permitted by Article 2.22 of this Act." See discussion in text accompanying notes 557-70 infra.

Lastly, the shares "shall have been issued to its shareholders without any public offering, solicitation, or advertisement." This language is designed to encompass both federal and state standards as to the nature of the private offering concept. Comment of Bar Committee to Art. 2.30-1, 3A **TEX. REV. CIV. STAT. ANN.** 76, 77 (Supp. 1974). The phrase "without any public . . . solicitation or advertisement" is taken again from section 5.1 of the Texas Securities Act and here, too, the Board's interpretation referred to above, should prove helpful. See also Bromberg, **Texas Exemptions for Small Offerings of Corporate Securities—The Prohibition on Advertisements,** 20 **SW. L.J.** 239 (1966); Lebowitz, supra note 131, at 131. Many of the federal concepts of the private offering exemption can be found in the SEC's recently promulgated rule 146 which became effective June 10, 1974. **SEC Securities Act Release No. 5487** (April 23, 1974), 17 **C.F.R.** § 230.146 (1974). The literature on the federal private offering exemption is voluminous. See generally 2 **H. BLOOMENTHAL,** supra note 163, § 4.05; **S. GOLDBERG,** **PRIVATE PLACEMENTS AND RESTRICTED SECURITIES** (1973); 1 **L. LOSS,** supra note 66, at 653-96 (1961); **H. SOWARDS,** **BUSINESS ORGANIZATIONS—SECURITIES REGULATION** § 4.02 (1971).

514. See discussion in text accompanying notes 557-70 infra.
main a number of other TBCA articles, not all of which were altered in 1973, that clearly were drafted with the close corporation in mind and will continue to be of benefit to both defined and other close corporations. Among such provisions are those permitting high quorum and voting requirements for action by the shareholders or directors (the “veto” power), classification of shares, voting trusts, certain voting agreements, or appointment of a receiver to break a deadlock among directors or shareholders. Moreover, some of the 1973 amendments previously discussed will offer more flexibility in planning for control in close corporations. Specifically, the new provisions authorizing disproportionate voting, allowing a one- or two-man board of directors, protecting directors elected through cumulative voting from removal by the majority, and giving new rights to holders of beneficial interests in voting trusts, should all prove helpful. Any of these statutes, whether new or old, can be employed, since nothing in the TBCA definition of a close corporation is intended to affect the right of any other corporation to provide for corporate management or restrict transferability or to exercise any other power or right otherwise provided by the Act.

There is no doubt that of all these changes in the Texas law of close corporations, the integrated close corporation statutes will have the greatest impact since they automatically apply to any corporation that falls within the statutory definition without need for any action to elect close corporation status. But two observations are in order on this point. First, these statutes are far from constituting a separate code for close corporations comparable to those found in Texas law for banks or insurance companies; rather the defined close corporation will continue to be governed by

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515. **TEX. BUS. CORP. ACT ANN. arts. 2.28, 2.35, 9.08 (Supp. 1974).**
516. **Id. art. 2.12(A) (1956).**
517. **Id. art. 2.30(A).**
518. **Id. art. 2.30(B) (Supp. 1974).**
519. **Id. arts. 7.05(A)(1)(b) (1956), (e) (Supp. 1974).**
520. **Id. art. 2.29(A) (Supp. 1974); see discussion in text accompanying notes 206-26 supra.**
521. **Id. art. 2.32; see discussion in text accompanying notes 364-72 supra.**
522. **Id. (last sentence); see discussion in text accompanying notes 251-60 supra.**
523. **Such beneficial holders are given the same rights to inspect corporate records and receive information as to the corporation’s financial conditions as are accorded record holders. TEX. BUS. CORP. ACT ANN. art. 2.44 (Supp. 1974); see discussion in text accompanying notes 503-11 supra and notes 619-36 infra. They are also permitted to initiate derivative actions if otherwise qualified. Id. art. 5.14(B)(1); see discussion in text accompanying notes 678-704 infra.**
524. **TEX. BUS. CORP. ACT ANN. art. 2.30-1(A) (Supp. 1974).**
525. **In this regard Texas has followed the pattern of close corporation legislation in Florida and Maine in making the law uniformly applicable to all close corporations as defined therein in contrast to that used in Delaware, Kansas, Maryland, Pennsylvania, and Rhode Island which require close corporations desiring to take the benefit of such special legislation to elect that status. Compare FLA. STAT. ANN. ¶ 608.70(1) (Supp. 1974) and ME. REV. STAT. ANN. tit. 13A, ¶ 102 (Supp. 1973) with DEL. CODE ANN. tit. 8, ¶ 344 (Supp. 1971); KAN. STAT. ANN. §§ 17-7201 to -7204 (Supp. 1973); MD. ANN. CODE art. 23, ¶ 100(a) (1973); PA. STAT. ANN. tit. 15, §§ 1371-74 (Supp. 1974); R.I. GEN. LAWS §§ 7-1.1-51(a) (1970). However, the Bar Committee as part of its 1975 legislative program plans to recommend that Texas also require an election of close corporation status to come under the new statutes.**
526. **TEX. REV. CIV. STAT. ANN. arts. 342-301 to -911.1 (1973).**
527. **E.g., TEX. INS. CODE ANN. arts. 2.01-21, 3.01-.69 (1963).**
the TBCA “to the extent not inconsistent with” the new legislation.\(^{528}\) Secondly, they are largely optional in nature and are really no more than enabling legislation to allow shareholders in certain close corporations essentially the same freedom of contract in structuring their corporation’s affairs as if they were partners, but only if they so choose.\(^ {529}\) In short, despite their sweep, these provisions are permissive, not mandatory.

**The Defined Close Corporation Statutes.** The bulk of the 1973 legislation for the defined close corporation consists of five new articles that have been added to the TBCA, articles 2.30-1 to 2.30-5.\(^ {530}\) In addition, several other articles were amended to permit inclusion or removal of optional provisions in the close corporation’s articles of incorporation authorizing shareholder management or granting one or more shareholders the option of dissolving the corporation, as permitted by the new law.\(^ {531}\) In a sense, article 2.30-1(A), which contains the definition of a close corporation, is the very core of these statutes since utilization of the privileges they afford depends almost entirely on the corporation maintaining its status as a close corporation as defined. Thus a corporation managed by its shareholders will be obligated to reinstate management by a board of directors if it no longer meets the definition.\(^ {532}\) Similarly, an agreement among all the shareholders which regulates the corporation’s affairs beyond that normally permitted in a shareholders’ agreement is valid only so long as its close corporation status is maintained.\(^ {533}\) For this reason, a special proceeding has been authorized to prevent loss of, or to restore close corporation status when wrongfully or inadvertently endangered.\(^ {534}\)

**Control Arrangements.** A small closely-held enterprise composed of a handful of shareholders all active in the business has very little need for adherence to the normal structure of corporate government which contem-

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532. *Tex. Bus. Corp. Act Ann.* art. 2.30-1(C) (Supp. 1974). The president must call a special meeting of the shareholders to elect the board; if he fails to do so within four months after the corporation no longer qualifies as a close corporation, any shareholder may call the meeting. The number of directors is to be that specified in the articles or bylaws, but if neither document says, then three directors are to be elected.
533. *Id.* art. 2.30-2(D). As drafted, this section seems to negate all the terms of such an agreement, even those that would otherwise be lawful in the absence of the broad authorization of subject matter set out in section A, such as restrictions on transfer or pooling of shareholders’ votes. As a consequence, special precautions should be taken to preserve the close corporation’s status or else place the matters that may normally be provided for or agreed upon in any type of corporation in some other document such as the articles, bylaws, or an agreement to which the corporation is a party.
534. *Id.* art. 2.30-3. The proceeding may be brought by the close corporation or one of its shareholders or by one who is party to or is bound by an agreement among all the shareholders by filing a petition in any court of competent jurisdiction in the county where the corporation’s principal place of business is located. The court may grant relief by way of injunction, specific performance, receivership, or any other appropriate remedy. If necessary, it may enjoin or set aside any transfer of shares or public offering that threatens the close corporation’s status or is contrary to any restriction on transferability permitted by article 2.22 or prohibited by agreement.
plates shareholders' meetings to elect representatives known as directors who then convene periodically as a board to determine corporate policy and select the executives who will conduct day-to-day operations. Once ownership and management meld, the whole concept of shareholder representation through a board of directors loses its reason for being. Hence, under article 2.30-1(B), a defined close corporation can elect to dispense with a board of directors and by an appropriate provision in its articles of incorporation conspicuously noted on its share certificates allow its business and affairs to be managed by its shareholders. In taking action for the corporation as managers, the shareholders may act formally or in any manner that evidences their consent to the transaction in question, and of course must bear the responsibilities imposed by law on the directors.

A decision to dispense with the board of directors may not of itself affect control, however, since presumably the shareholders will vote according to their shareholdings and not per capita. However, if the shareholders of a defined close corporation choose, they can by a unanimous agreement among themselves impinge as they see fit on the managerial prerogatives of the board, if not abolished, or permit one or more of their number or outsiders to run the corporation or in essence treat the business and affairs of the corporation as if it were a partnership. Moreover, they can decide how voting requirements or power will be exercised, the terms and conditions of employment of all corporate offices and employees including who the directors and officers will be and the manner dividends will be declared and profits divided. In addition, they may impose restrictions on transfer seemingly in excess of those otherwise permitted by law and in general work out the relationship among themselves and the corporation as if they were partners. Because of the far-reaching nature of such an agreement, it must not only be unanimously agreed to but must be set out in full or incorporated by reference in the articles or bylaws and its existence conspicuously noted on the share certificates.

535. Id. art. 2.30-1(B)(3).
536. Id. art. 2.30-1(B)(2).
537. The statute does not say so specifically but this interpretation is consistent with the policy of permitting the board to be dispensed with entirely as a useless appendage and letting the shareholders run the corporation in accordance with their ownership interests. But as Professor Hamilton suggests, the language is ambiguous and could lead to the contrary inference that voting is to be per capita as directors vote, although he agrees the voting should be by share holdings. 20 R. HAMILTON, TEXAS BUSINESS ORGANIZATIONS § 697, at 20 n.98 (Supp. 1974). Interestingly, only the Maryland statute of all the close corporation legislation is explicit on this point. MD. ANN. CODE art. 23, §§ 105(a)(5), (6) (1973) (action by voting of shares of stock).
538. Id. art. 2.30-2(A)(1)(a), (b) (Supp. 1974).
539. Id. art. 2.30-2(A)(2) to (6).
540. Id. art. 2.30-2(A)(2). Though the statute speaks only of "restrictions on the transfer of shares," the general permission granted that allows the agreement to regulate the relations of the shareholders in a manner that would otherwise be appropriate only among partners suggests that any restraint partnership law permits to preserve the delictus personae concept should be valid, even if beyond those stated in article 2.22.
541. Id. art. 2.30-2(A)(8) (Supp. 1974).
542. Id. art. 2.30-2(B). This requirement is critical, because the validity of the entire agreement is made dependent upon its inclusion in the articles or bylaws. It has been imposed in the belief that since the shareholders' agreement will form the basic compact among the shareholders, it should be included in either of those documents. Comment of Bar Committee to Art. 2.30-2, 3A TEX. REV. CIV. STAT. ANN. 79 (Supp. 1974). By
Deadlock, Dissension, and Dissolution. Because of the intimacy of association among shareholders in most close corporations, it is not surprising that disagreements and discord sometimes result. If the dissension persists or becomes of such intensity that some of the associates would like to terminate the relationship, they may find themselves frozen in. A more likely consequence is that either through spiteful exercise of a veto power or because of equality of voting strength, corporate affairs will become deadlocked. Heretofore, the only remedy in the absence of an agreement has been a receivership to rehabilitate the corporation that might ultimately lead to dissolution, but receivership is a remedy not easily obtained. Now, three of the 1973 close corporation articles provide additional solutions for the defined close corporation.

Under article 2.30-4, the corporation, or shareholder, or one who is party to or bound by an agreement among the shareholders can seek judicial appointment of a provisional director whenever the directors (or shareholders, if they have power of management) become so deadlocked that the corporation's affairs can no longer be conducted to the advantage of the shareholders generally. The provisional director, who cannot be a shareholder or creditor and who does not have the powers of a receiver, is given a director's (or shareholder's) right to vote which ordinarily will permit him to break the deadlock, and he serves until removed by the court or a vote of the directors or shareholders, if the latter later decide they would rather resolve their own differences than have an outsider meddle in their affairs.

As an alternative to judicial intervention, the shareholders may want contrast, failure to note the agreement's existence conspicuously on the share certificates simply makes its terms unenforceable against certain transferees without actual notice.

543. TEX. BUS. CORP. ACT ANN. art. 2.30-2(C) (Supp. 1974). In general, the agreement must be set out in full or summary form on the front or back of the certificate or, if set out in or incorporated by reference in the articles or bylaws, a statement can be made of its availability at the corporation's registered office and principal place of business or in the office of the secretary of state, if filed there. If the statement is set forth on the back of the certificate, conspicuous reference to it is required on the face of the certificate.

544. Typically the corporation's articles will have provided for perpetual duration and if the shareholders do not have sufficient votes to force voluntary dissolution, they have no basis to seek receivership or ultimate involuntary dissolution unless they can show insolvency, wasting of corporate assets, oppression by the majority, or a deadlock situation. TEX. BUS. CORP. ACT ANN. arts. 7.05, 7.06 (Supp. 1974). True, they may try to sell their shares but this assumes a purchaser can be found who wants to buy into a business wracked with dissension, or if shares cannot be transferred without giving the other shareholders or corporation a first option, that the option will be exercised.

545. See generally 20 R. HAMILTON, TEXAS BUSINESS ORGANIZATIONS § 689; 2 F. O'NEAL, CLOSE CORPORATIONS § 9.02; W. PAINTER, CLOSELY HELD CORPORATIONS 257; C. ROHRLICH, supra note 88, § 4.28.

546. TEX. BUS. CORP. ACT ANN. arts. 7.05(A)(1)(b) (1956), (e) (Supp. 1974).

547. Id. art. 7.06(A)(3) (Supp. 1974).

548. In order for a receiver to be appointed to rehabilitate the corporation in the event of deadlock, it is necessary to show that all other remedies either in law or in equity are inadequate. Even if such a receiver is appointed, the court will not proceed to liquidate the corporation's assets unless no plan for remedying the situation has been presented within twelve months after his appointment. In general, attempts by minority shareholders to obtain receivership have not been successful. 20 R. HAMILTON, TEXAS BUSINESS ORGANIZATIONS § 692.

549. TEX. BUS. CORP. ACT ANN. art. 2.30-4(A) (Supp. 1974).

550. Id. art. 2.30-4(B).

551. But such intervention cannot be completely avoided, since a court has power to appoint a provisional director "notwithstanding any contrary provision in the articles of
to work out their own methods for settling internal disputes. If they all join in an agreement sanctioned by article 2.30-2, they can include any provision they desire providing for arbitration of issues when deadlock ensues and, given the broad freedom of contract that statute affords, undoubtly may provide for a first option or mandatory buy-out by one or the other of the disagreeing parties. Article 2.30-5 permits an even more drastic solution: if the articles of incorporation so provide and again the share certificates so conspicuously indicate, one or more shareholders can be given an option to dissolve the corporation at will or on the happening of any event or contingency, and there is no reason why a deadlock situation or refusal to abide by an arbitrator's award cannot be such a contingency. The power, if conferred, is equivalent to that given a partner under partnership law, and as in partnerships, the danger of its exercise should be hedged against by allowing the remaining shareholders to continue the corporation's business, if they wish, by buying out the dissident's shares.

Restrictions on Transferability. Although technically not part of the close corporation statutes, the amendment of article 2.22 relating to restrictions on the transfer of shares is of great importance since one of the essential requirements for a defined close corporation is that its issued shares of all classes be subject to one or more of the restrictions set out in article 222. That statute has been almost completely revised, not only to clarify some of the ambiguities in the former language that may have led to the unfortunate decision by the Waco court of civil appeals in Ling & Co. v. Trinity Savings & Loan Ass'n and to give statutory recognition to restrictions currently being imposed to assure compliance with federal and state securities laws, but also to allow the corporation's status as an electing small business corporation under subchapter S of the Internal Revenue Code or as a defined close corporation to be preserved.

incorporation, or bylaws, or agreement among shareholders of a close corporation."


552. Id. art. 2.30-2(A)(7).

553. See 20 R. Hamilton, Texas Business Organizations § 691 for a form for a first-option arrangement in the event of deadlock. But even with such an agreement, problems can arise as to the manner in which the option is exercised or offer made to purchase the other's shares. See, e.g., Roy Herider Feed Co. v. Modern Feeds of Nacogdoches, Inc., 468 S.W.2d 554 (Tex. Civ. App.-Tyler 1971), error ref. n.r.e., discussed in Lebowitz, supra note 131, at 154. See generally 2 F. O'Neal, Close Corporations § 9.05.


555. Tex. Rev. Civ. Stat. Ann. art. 6132b, § 31(1)(b) (1962) (partner may dissolve partnership at will without violation of the partnership agreement if no definite term or undertaking has been specified). But unlike the shareholder in a close corporation, a partner has power to dissolve the partnership even in contravention of the partnership agreement at any time, id. § 31(2), but is liable to his co-partners for the damages thus caused. Id. § 38(2)(a)(II).

556. See generally A. Bromberg, Crane and Bromberg on Partnership 476 (1968); 2 F. O'Neal, Close Corporations § 9.06.


559. 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), discussed in Lebowitz, supra note 166, at 96; Rogers, Stock Transfer Restrictions, 10 Bull. of the Section on Corp., Banking & Bus. L. June 1972, at 1.

560. Doty & Parker 1016.

As drafted, article 2.22 focuses primarily on the manner of imposing, and the permissible scope of restrictions on the transfer of shares or other corporate securities, but begins nevertheless with a statement that such securities are personal property for all purposes and are transferable in accordance with the Texas equivalent of article 8 of the Uniform Commercial Code, except as otherwise provided by the TBCA. Section B specifies the sources for the imposition of such restrictions as being the articles, bylaws, agreements among any number of shareholders, and agreements among the shareholders and corporation provided the latter keeps a counterpart at its principal place of business and registered office where it may be inspected. The section also seemingly codifies the holding in Sandor Petroleum Corp. v. Williams that previously unrestricted shares cannot be restricted without the consent of the holder either by voting for the restriction or becoming a party to an agreement imposing it.

To be enforceable, a restriction must be reasonable and must be noted conspicuously on the share certificates, and if imposed by the corporation, in the manner prescribed by article 2.19(G). "Conspicuously" is basically defined in terms of use of type of sufficient size, color, and character that would cause a reasonable person against whom the legend will operate to notice it. Absent the conspicuous notation, the restriction is enforceable only against a person who actually knows about it. The reasonableness requirement is not defined and ultimately can only be determined as to any specific restriction by the courts. Some guidance is provided, however, in section D which sets out several varieties of permissible restraints, again provided they are reasonable. The list is not exhaustive but covers most of the common type of restrictions such as options to purchase, first refusals, buy-sell agreements, and limited consent restraints to keep out undesirable persons or classes of persons (if the designation is not "manifestly" unreasonable) or to prevent violations of securities laws or loss of status as a subchapter S or defined close corporation.

B. Case Law Developments

During the survey period the Texas courts decided three cases that con-
cerned close corporations and all involved stock transfer restrictions imposed in conjunction with buy-sell or first option arrangements. In each the outcome depended largely on construction of the language used in imposing the restrictions or on the validity of efforts made to implement them.

The first case, *Rainwater v. Milfeld*, 571 dealt largely with rights of successive optionees given as first refusals572 and the application of bylaw provisions granting the options. According to the facts, the plaintiff and his father had purchased fifty percent of the stock in a motel corporation, the other fifty percent being owned by two others, the Milfelds, who had formed the corporation with plaintiff's sellers. The plaintiff took five percent of the block and his father forty-five percent. Under the corporation's bylaws, the corporation and its shareholders were given successive options to buy the stock of a shareholder desiring to sell at the price or value a bona fide prospective purchaser was willing to give. The offer to sell had to be made first to the corporation and if it refused, then to the remaining shareholders, each of whom had the right to buy his proportionate share plus a proportionate part of any stock not taken by other shareholders.

The Milfelds received an offer from an outsider to buy their fifty percent block, the latter specifying he would not be interested in acquiring less than a fifty percent position. The Rainwaters were duly notified as the bylaws required. Their attorneys responded, rejecting the offer in behalf of the corporation and plaintiff's father, but stating that plaintiff was exercising his option to purchase five percent of the Milfeld stock, his proportionate share. When the Milfelds refused to transfer the shares to him, plaintiff sued for specific performance. The trial court found for the defendants and the Corpus Christi court of civil appeals affirmed.

As the appellate court interpreted the contract, once a selling shareholder offers his stock and the corporation declines to buy it, all of the stock then alternatively offered must be purchased by the remaining shareholders in the proportions specified by the bylaws in order for the restriction to stand. If not, it would be unreasonable to allow an individual shareholder to purchase his proportionate share of the total unless either he or his other shareholders take the balance. Because the ownership was evenly divided between the two groups and there had been some discord between them, it was evident that neither group nor an outside purchaser of their shares would want to be placed in the minority position which would result from

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572. Although the term "first option" is often generically used to describe any obligation giving the corporation or the other shareholders the initial opportunity to acquire restricted securities (and is employed in that sense in amended article 2.22(D)(1)), there appears to be a difference between a true "first option" and a "first refusal." In the former, the opportunity given the other contracting parties is to purchase at a fixed price or according to an agreed formula; in the latter, the selling shareholder can in a sense fix the price at whatever amount he is willing to sell to an outsider who agrees to pay that much, as in the instant case. *See* 1 HORNSTEIN 251 n.43. Article 2.22 prior to its amendment referred both to rights of the corporation or other persons "granted as an option or options or refusal or refusals on any shares." Ch. 64, art. 2.22(B)(3), [1955] Tex. Laws 239, *as amended*, *Tex. Bus. Corp. Act Ann.* art. 2.22(B) (Supp. 1974). The court, however, referred only to another provision of the former article concerning preemptive or prior rights of the corporation or its shareholders to purchase shares offered for transfer. *Id.* art. 2.22(D)(1).
being forced to give up part of their shares. There being no right to buy anything less than all the stock being offered, plaintiff's response was simply a counteroffer that was not accepted.

The court's interpretation undoubtedly accorded with the intent of the parties although the bylaw was not as free of ambiguity as the court seemed to think, absent an explicit statement that the successive options to the corporation and shareholders would fail if all the shares were not taken. On the other hand, the bylaw did not contain the provision often found in such arrangements that any portion of the stock not purchased by either the corporation or the shareholders on a proportionate basis can then be sold to others. In any event, the case emphasizes the need for careful draftsmanship in formulating successive options and for being certain the parties decide beforehand what action should be taken if not all the shares offered are purchased.

The second opinion, Gulf States Abrasive Manufacturing, Inc. v. Oertel, focused mainly on the validity of the issuance of shares. Part of the case, however, concerned the value of the shares in question. The dispute centered on a determination by a master appointed by agreement that the shares were worth two dollars each when a bylaw of the corporation stipulated that the price to be paid a shareholder for his shares upon death, incapacity, or separation from his duties with the corporation was to be "a minimum of ONE DOLLAR ($1.00) per share." The court upheld the master's valuation of the stock as not in conflict with the bylaw, since as it sensibly concluded, the bylaw established a minimum price but made no provision for determining how much more than that amount could be paid.

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573. 485 S.W.2d at 835-36. The court set out what it considered the unambiguous meaning of the bylaw provision to be, quoting the Texas Supreme Court's synopsis of the general rules regarding construction of unambiguous written instruments in City of Pinehurst v. Spooner Addition Water Co., 432 S.W.2d 515, 516 (Tex. 1968).


575. 2 F. O'NEAL, CLOSE CORPORATIONS § 7.22; cf. W. PAINTER, CLOSELY HELD CORPORATIONS 93; C. ROHRlich, supra note 88, § 4.25. For a somewhat comparable case see Helmy v. Schulz, 219 Ga. 201, 131 S.E.2d 924 (1963) (offer to sell to stockholders pursuant to first option restriction in bylaws; court holds all shareholders must buy their proportionate share and hence offer not accepted by single shareholder saying he would buy his share and all stock not taken by others). Cf. Alkire v. Dugan Drug Stores, Inc., 468 S.W.2d 492 (Tex. Civ. App.—Houston [1st Dist.] 1971), error ref. n.r.e., discussed in Lebowitz, supra note 131, at 155.

576. 489 S.W.2d 184 (Tex. Civ. App.—Houston [1st Dist.] 1972), error ref. n.r.e.

577. Plaintiff sued the corporation for conversion of 25,000 shares he claimed had been wrongfully cancelled. The corporation asserted the shares had been improperly issued because their consideration had been a promissory note executed by the plaintiff in the corporation's favor in violation of Tex. Const. art. XII, § 6 and Tex. Bus. Corp. Act Ann. art. 2.16(B) (1956). 489 S.W.2d at 185. The jury, however, found that the shares had been issued for the plaintiff's work in organizing the corporation and getting its product on the market and plaintiff was awarded judgment on that basis. The corporation tried to invoke judicial estoppel to overturn the judgment because the plaintiff had alleged under oath in a federal tax court proceeding that he had not received the shares in the taxable year in question or that if he had they were not compensation or income. But the corporation had failed to plead judicial estoppel, an affirmative defense, and though the plaintiff had not objected to the admission of a certified copy of his sworn petition in the tax proceeding, the appellate court determined this did not indicate the issue was tried with his consent. Id. at 186-87.

578. 489 S.W.2d at 187.

579. The problem of determining the value of stock in a close corporation is a diffi-
The third case, Hall v. Weller, Hall & Jeffery, Inc.,580 is likewise discussed more extensively elsewhere as an important holding on the extent of a corporation's power to repurchase shares pursuant to a buy-sell agreement.581 The agreement provided that to the extent the corporation might be prevented by law from purchasing all or any portion of the stock obligated to be sold to it, the remaining shareholders would then have to purchase the portion not bought by the corporation. Although the appellate court ruled the trial court erred in ordering the corporation to buy the plaintiff's shares under the agreement in view of its financial position, it required that this aspect of the agreement be carried out by the remaining shareholders after the amount they were obligated to buy was determined upon remand.582

IV. SHAREHOLDERS' RIGHTS

American law vests shareholders with a number of rights,583 but not all are absolute. If the articles of incorporation so provide rights, for example, to elect directors,584 participate equitably in the distribution of dividends,585 or purchase a pro rata part of any new offering of shares for cash,586 may be limited. Others, such as rights to inspect corporate records if for a proper purpose,587 resort to the appraisal remedy if dissenting to mergers or similar combinations,588 or vote on fundamental changes in the corporation's structure589 or continuation of its existence,590 generally cannot be abridged except as provided by law.

The degree to which shareholders' rights should be curtailed has been the subject of continuing debate, depending largely on whether viewed from the vantage point of management or outside investors, and often couched in terms of corporate democracy versus managerial autonomy in fulfilling the

580. 497 S.W.2d 374 (Tex. Civ. App.-Houston [1st Dist.] 1973), error ref. n.r.e.
581. In brief, the trial court had ordered the corporation to repurchase the plaintiff's shares under the agreement although the amount it adjudged he was entitled to be paid therefor in the form of a promissory note far exceeded the total of the corporation's stated capital and surplus. The court of civil appeals reversed because the repurchase contravened the permissible limits on the corporation's right to reacquire its own shares delineated in the TBCA. Id. at 376-77. This aspect of the case will be developed more fully in the second half of this survey when published.
582. Id. at 377.
583. See 5 Z. CAVITCH, supra note 21, § 108.04, and 13 W. FLETCHER, CYCLOPEDIA CORPORATIONS § 5717 for lists of shareholder's rights.
586. See, e.g., id. art. 2.22-1(A) (Supp. 1974).
587. See, e.g., id. art. 2.44(B).
588. See, e.g., id. arts. 5.11-13.
589. See, e.g., id. arts. 5.03(B), 5.10(A)(3).
590. See, e.g., id. art. 6.03(A)(3).
corporation's role in a modern capitalistic society. The TBCA traditionally has attempted to strike a balance between the interests of the two groups (where they do not coalesce as in the close corporation), and the 1973 amendments which concern shareholders continue that pattern. Some, particularly the amendments dealing with inspection of corporate records, cumulative voting, and management in defined close corporations, are designed to strengthen their rights. Others that, for example, permit a reduction in the percentage needed for shareholder approval of certain matters from two-thirds to a majority or greater vote, or that grant the board the primary power to amend the bylaws or enlarge its powers to enter into corporate guaranties or repurchase shares clearly give management greater freedom of action. Still others, particularly the amendments redefining preemptive rights and relating to shareholders' derivative suits both enlarge and contract the rights shareholders previously had.

Many of the 1973 amendments that affect shareholders' rights have already been commented upon, including those dealing with voting: re-
moval of directors, amendment of bylaws and reporting of financial data. In particular, the new close corporation statutes give shareholders of a defined close corporation sweeping yet optional powers of management and almost complete freedom of contract to operate the corporation as if it were a partnership. In addition, the same statutes, along with other amendments previously noted, have broadened the actions shareholders can bring to enforce or protect their individual or collective rights. Thus shareholders in a defined close corporation may institute litigation to preserve the close corporation's status or gain appointment of a provisional director to resolve a deadlock situation. Similarly, any shareholder may sue to prevent the making of a guaranty not reasonably expected to benefit the corporation, or if made, to hold the directors accountable therefor, or, in another context, to apply for summary relief if the annual meeting has not been held within thirteen months. There remain, however, four amendments that have made significant changes in the law relating to shareholders' preemptive rights and rights to inspect corporate records, dissent, or institute derivative actions.

Right of Inspection. One of the most fundamental rights a shareholder has as an ultimate owner of his corporation's property and assets is to be able to inspect its books and records at reasonable times to determine its financial condition, check on its general state of affairs and management, or ascertain who the other shareholders are in order to protect his own or the corporation's overall interests. The right is one almost universally recognized in American common law and has been confirmed in the statutory law of virtually all the states. Even prior to the adoption of the TBCA, Texas recognized the right by statute, seemingly in absolute terms. Nevertheless, because of the discretionary nature of manda-

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603. See discussion in text accompanying notes 426-45 supra.
604. See discussion in text accompanying notes 61-68 supra.
605. See discussion in text accompanying notes 503-11 supra.
606. See text accompanying notes 535-37 supra.
607. See text accompanying notes 538-41 supra.
608. See text accompanying note 534 supra.
609. See text accompanying notes 544-50 supra.
610. See discussion in text accompanying notes 90-146 supra.
612. See ABA Model Bus. Corp. Act Ann. 2d, § 52, ¶¶ 3.01-04; 6 Z. CAVITCH, supra note 21, § 116.04; 5 W. FLETCHER, CYCLOPEDIA CORPORATIONS §§ 2215-15.1 for various summaries of and references to applicable state statutes.
mus, regarded as the only remedy available for the enforcement of this right, its availability depended in the final analysis on whether a court could be convinced that the shareholder making the demand was not acting in good faith or for a proper purpose. The burden of proof to show improper purpose rested, however, with the corporation (or other defendants); to make a prima facie case the shareholder merely had to allege his interest as a shareholder and the corporation's refusal to allow inspection after a proper demand.

The TBCA as adopted in 1955 also recognized the shareholder's right of inspection in article 2.44, a much more detailed provision taken mainly from the Model Act. Yet despite some apparently more restrictive language due to greater specificity as to the books and records subject to examination, no real change was effected in the law except in one very


617. Moore v. Rock Creek Oil Corp., 59 S.W.2d 815, 818 (Tex. Comm'n App. 1933), judgment adopted. The propriety of the purpose for which a shareholder seeks to assert his inspection right is one that courts sometimes disagree upon since there must be some balance between the shareholder's interest in seeking information and the corporation's interest in keeping from being harassed or even injured by unwarranted demands. See 20 R. Hamilton, Texas Business Organizations § 804, at 337 n.34. In general, the Texas courts have taken a fairly liberal view of the proper purpose requirement. For example, inspection has been upheld even where the purpose has been determined if there have been bad management practices, Grayburg Oil Co. v. Jarratt, 16 S.W.2d 319, 320 (Tex. Civ. App.—El Paso 1929), or to find something that might alarm the other shareholders as to the corporation's financial condition, Moore v. Rock Creek Oil Corp., supra. Nor does it matter, as the Moore case states, that the shareholder seeking inspection is on unfriendly terms with the company. Id. On the other hand, if the inspection is for purposes of aiding a competitor, see Uvalde Rock Asphalt Co. v. Loughridge, 425 S.W.2d 818 (Tex. 1968), discussed in Amsler, supra note 124, at 106, or to defraud the corporation, see Roberts v. Munroe, 193 S.W. 734, 736-37 (Tex. Civ. App.—Austin 1917), error dismissed, to obtain a list of shareholders for resale for commercial purposes, cf. Tex. Bus. Corp. Act Ann. art. 2.44(C) (Supp. 1974), relief by way of mandamus will undoubtedly be denied. For a general discussion and listing of proper and improper purposes, see Cary 1020; 6 Z. Cavitch, supra note 21, § 116.02; 5 W. Fletcher, Cyclopaedia Corporations §§ 2222-2226.4.


620. ABA Model Bus. Corp. Act § 46 (1953) (now ABA Model Bus. Corp. Act Ann. 2d, § 52). When considered by the original draftsmen of the TBCA, the Model Act provision contained five paragraphs that, respectively, established the general requirement that books and records be kept, gave a shareholder who met certain requirements the right to inspect upon reasonable demand, imposed a penalty for refusal, saved rights of other shareholders to enforce inspection right upon proof of proper purpose, and required that financial data be sent out upon request. The TBCA draftsmen used only the first, second, and fourth paragraphs as sections (A), (B), and (C) respectively, of article 2.44. The 1973 amendment in essence has picked up the two missing paragraphs but with some modifications. See notes 499, 503 supra, and notes 626-35, 647-49 infra.

621. Whereas the former law permitted access to all “books and records,” the TBCA, again using Model Act language, refers to “books and records of account, minutes, and required that financial data be sent out upon request. The TBCA draftsmen used only the first, second, and fourth paragraphs as sections (A), (B), and (C) respectively, of article 2.44. The 1973 amendment in essence has picked up the two missing paragraphs but with some modifications. See notes 499, 503 supra, and notes 626-35, 647-49 infra.
important respect. A shareholder who had not owned his shares for at least six months prior to making his demand or who did not own at least five percent of the outstanding shares would not be required to prove a proper purpose for his demand if he sought judicial aid to compel inspection.\(^6\) Indeed, even a shareholder who satisfied the six-months or five-percent requirement had to state the purpose for seeking inspection in a written demand therefor and his right, too, was conditioned on the propriety of the demand, but there was no specification that he had to prove the same.\(^7\) The net effect, therefore, was to shift the burden of pleading and proving proper purpose to the shareholder if he had very recently acquired a small percentage of shares, and at least the burden of allegation with respect to any other shareholder.\(^8\)

Article 2.44 was amended in several respects in 1973,\(^9\) but none of the changes affected the allocation of pleading and proof just described. Even so, one of the three new sections that have been added to the article\(^10\) may well make the whole matter academic in many situations. The section is designed to discourage a refusal based on the usual reason for which an inspection demand is improperly turned down, i.e., management's decision that the shareholder making the demand, however proper his purpose otherwise, is either hostile (to themselves) or simply pestiferous and therefore justifies resort to the delaying tactic of putting him to the time and expense of litigation to enforce his right.\(^11\) Thus, to make it unlikely that a reason-

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\(^6\) See, e.g., Johnson Ranch Royalty Co. v. Hickey, 31 S.W.2d 150, 151-52 (Tex. Civ. App.—Amarillo 1930), error ref., permitting inspection of "record books, books of account, receipts, vouchers, bills, papers, and all other documents in any way evidencing the financial condition of the corporation." See generally 20 R. Hamilton, Texas Business Organizations § 804, at 335; Comment, supra note 616, at 62.

\(^7\) Tex. Bus. Corp. Act Ann. art. 2.44(C) (1956) (now art. 2.44(D)). Such shareholder presumably could only examine the records himself, thus not including examination by attorney or agent or the making of extracts therefrom as permitted other shareholders in art. 2.44(B), but again it is doubtful a Texas court would so limit his inspection.

\(^8\) Ch. 64, art. 2.44(B), [1955] Tex. Laws 239, Tex. Bus. Corp. Act Ann. art. 2.44(B) (1956).

\(^9\) Professor Hamilton believes, and quite correctly, that the absence of the phrase "upon proof by a shareholder" in section B can only mean that at most the shareholder whose ownership meets the requirement of that section must allege a proper purpose and therefore the corporation must continue to prove the absence of such purpose. 20 R. Hamilton, Texas Business Organizations § 804, at 334; see Texas Infra-Red Radiant Co. v. Erwin, 397 S.W.2d 491, 493 (Tex. Civ. App.—Eastland 1965), error ref. n.e., discussed in Pelletier, supra note 133, at 152, noted in 19 Sw. L.J. 851 (1965); cf. Sierk, Shareholders' Rights Under Texas Business Corporation Act, 26 Tex. B.J. 25 (1963). This view is also consistent with that expressed in Moore v. Rock Creek Oil Corp., 59 S.W.2d 815, 818 (Tex. Comm'n App. 1933), judgment adopted, that when the inspection right is conferred by statute, the effect is to change the common law rule requiring the shareholder to establish that he is asking for inspection in good faith and for an honest purpose to one requiring the corporation to show he is actuated by corrupt or unlawful motives. See also Comment, supra note 616, at 76.


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able request of inspection will be refused, a corporation that refuses to allow an examination of or the taking of an extract from its books and records for a proper purpose by a shareholder of record for at least six months prior to his demand or who owns at least five percent of the outstanding shares will be liable for all costs and expenses, including attorneys’ fees, incurred in enforcing his inspection right, in addition to any other damages or remedy he can recover. This deterrent is in lieu of the monetary penalties suggested in the Model Act or provided for in other statutes, but has been employed in a few states. It is also consistent with the similar sanction that can be imposed on a shareholder who brings a derivative action without reasonable cause, presumably on the premise that what sauce for the goose should be sauce for the gander. The corporation can assert as a defense, however, that the shareholder has sold or offered for sale a list of shareholders of the corporation or any other corporation within the last two years or has aided or abetted others in procuring such lists, or has improperly used information obtained as the result of any prior inspection, or, somewhat redundantly, was not acting in good faith or for a

630. The Model Act makes an officer, agent, or the corporation which refuses to let the shareholder examine or make extracts from its records, for any proper purpose, liable to the shareholder or the holder of a voting trust certificate for a penalty of 10% of the value of the holder’s shares or beneficial interest. ABA Model Bus. Corp. Act Ann. 2d, § 52. See Starr & Schmidt, supra note 612, at 178, for a discussion of the Model Act 10% penalty provision.
634. It will be noted that only the corporation is liable for the payment of all costs and expenses to the shareholder, and not also the officer or agent responsible for the wrongful refusal. Most state statutes and the Model Act also subject these officials to the penalties they prescribe. See note 631 supra. While presumably the responsible officer or agent would be named as a defendant to the mandamus action to compel inspection, see 20 R. Hamilton, Texas Business Organizations § 809-11; L. Lowe, supra note 192, § 303, at 308 n.62, § 352, the net effect of the provision is to require the corporation to also be made a party if recovery of costs and expenses are being sought against it. Compare TBCA art. 2.27(C) making the officer or agent in charge of preparing the list of shareholders eligible to vote at a meeting who fails to prepare the list or keep it open for inspection liable to a shareholder for the damages caused thereby. But if his failure was due to lack of timely notification of the meeting’s date, then only the corporation becomes liable to the shareholder. Tex. Bus. Corp. Act Ann. art. 2.27 (C) (1956).
Although the statute does not say so expressly, this listing of reasons for denying recovery of costs could also be grounds for denying the award of mandamus to compel inspection in the first place.636

Several other changes should also be noted. One makes it clear that the shareholder may utilize an accountant as well as an attorney or other agent to assist him in making his examination,637 as had been held in an earlier case.638 Another limits the books and records that can be inspected to those that are "relevant,"639 with the obvious purpose of curtailing mere fishing expeditions and thus may narrow the rather expansive view of propriety of purpose stated in Moore v. Rock Creek Oil Corp.,640 the leading pre-TBCA opinion on inspection rights, where the commission of appeals found no reason to deny examination of the corporation's records simply because shareholders "hope to find something alarming in the affairs of the company, which they intend to communicate to other stockholders."

On the other hand, given enough imagination in formulating the purpose for making the demand, relevancy is not likely to become a serious obstacle.

The third group of changes relates to beneficial owners of shares. Prior to the 1973 amendments, it was not at all certain such owners had any right of inspection,642 because article 2.44 spoke only in terms of inspection rights of "record" holders of shares. Nevertheless, a 1965 civil appeals decision643 held that a divorced wife who had received a ten percent beneficial interest in a corporation's shares as part of the divorce had a common law right to inspect its books upon proof of proper purpose. Despite its questionable construction of then article 2.44(C),644 the court's ruling has

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635. Tex. Bus. Corp. Act Ann. art. 2.44(C) (Supp. 1974). The defenses are listed as defenses "to any action for penalties under this section." Technically, the award of costs and expenses to the successful plaintiff is not a penalty; the language is taken from the Model Act section which does impose a 10% penalty, see note 630 supra, and should be changed to reflect the nature of the cause of action given the shareholder under the Texas section. See 20 R. Hamilton, Texas Business Organizations § 809, n.63.10 (Supp. 1974). See also Starr & Schmidt, supra note 612, at 184.

636. See, e.g., State ex rel. Theile v. Cities Serv. Co., 31 Del. 514, 115 A. 773 (1922) (inspection denied where shareholder who owned only one share of stock was in business of selling shareholders lists); accord Chas. A. Day & Co. v. Booth, 123 Me. 443, 123 A. 557 (1924).


638. See Johnson Ranch Royalty Co. v. Hickey, 31 S.W.2d 150, 152 (Tex. Civ. App.—Amarillo 1930), error ref. (shareholder may use any duly authorized agent, including attorney, accountant, or stenographer); see Comment, supra note 616, at 66. See generally 5 W. Fletcher, Cyclopedia Corporations § 2233.

639. See note 621 supra.

640. 59 S.W.2d 815 (Tex. Comm'n App. 1933), judgment adopted.

641. Id. at 818. The court added: "If in truth and in fact no alarming condition exists, presumably it will not be found through any examination . . . . If there be existent anything in the financial affairs of the company which would be reasonably calculated to alarm the stockholders in general, we see no reason why plaintiffs in error could not properly communicate such fact to the other stockholders. The stockholders of a corporation are the beneficial owners of the corporate property, and are therefore vitally interested in knowing the true condition of its affairs." Id. at 818-19.

642. See Comment, supra note 616, at 72. The law elsewhere is also uncertain with some courts or statutes allowing beneficial owners the inspection right and others not. See generally 5 W. Fletcher, Cyclopedia Corporations § 2230, at 862; Lattin 350.


644. Despite the precise language of then section C of article 2.44 (now section
now been codified so that a beneficial owner, as well as the shareholder who does not meet the time or percentage of ownership requirement, may seek judicial enforcement of his inspection right if he sustains the burden of alleging and proving the propriety of his purpose in demanding inspection.\textsuperscript{645} He cannot, however, recover costs and expenses for a wrongful refusal, because recovery of that penalty is limited to record holders who satisfy the test.\textsuperscript{646} On the other hand, a holder of a beneficial interest in a voting trust that complies with the TBCA\textsuperscript{647} is considered a holder of record of the shares underlying his beneficial interest for all purposes of article 2.44\textsuperscript{648} (including the right to receive financial data if requested).\textsuperscript{649} As a consequence, whether he can enforce the inspection right without proof of proper purpose or recover the costs and expenses of a lawsuit if his proper demand has been refused will also depend, as in the case of a record holder, on the currency and size of his beneficial interest in relation to the shares represented thereby.\textsuperscript{650} Why the two types of beneficial ownership are treated differently is not at all clear, especially since beneficial ownership, particularly when shares are held in a street name,\textsuperscript{651} is much more common than participation in a voting trust. The obvious purpose of differentiating between recent and longer or more substantial stockholdings insofar as allocating the burden of proof of proper purpose or imposing sanc-

\textsuperscript{D} which allowed a shareholder who could prove a proper purpose to compel the production of corporate records for examination regardless of the period of time during which he had been "a shareholder of record, and irrespective of the number of shares held by him" (emphasis added), Tex. Bus. Corp. Act Ann. art. 2.44(C) (1956) the court construed the language to read that although the plaintiff was not a shareholder of record, "she could be granted the right of inspection simply on proof of proper purpose, since the purpose of section C was to save the common law right of inspection available upon such proof. Texas Infra-Red Radiant Co. v. Ervin, 397 S.W.2d 491, 493 (Tex. Civ. App.—Eastland 1965), error ref. n.r.e. This, of course, is contrary not only to what the section said, but also assumed that the common law accorded the right to beneficial owners, another questionable proposition, see note 642 supra. See generally 20 R. Hamilton, Texas Business Organizations § 804, at 334 n.19 (Supp. 1974); Pelletier, supra note 135, at 152.

645. Tex. Bus. Corp. Act Ann. art. 2.44(D) (Supp. 1974). The amendment still leaves uncertain whether such beneficial owners or holders of record who do not meet the time or percentage of holdings requirement may be assisted by an attorney, accountant, or agent or make extracts from the records, as shareholders who meet the requirement are permitted to do. See note 622 supra.


647. Tex. Bus. Corp. Act Ann. art. 2.30(A) (1956). The voting trust can last no longer than 10 years and a counterpart must be deposited with the corporation at its registered office where it is subject to examination either by shareholders or holders of a beneficial interest in the voting trust.

648. Tex. Bus. Corp. Act Ann. art. 2.44(F) (Supp. 1974). The equation of the voting trust certificate holder with a record holder is taken from the Model Act which, however, does not have the separate provision but refers to both types of holders in tandem throughout section 52. ABA Model Bus. Corp. Act Ann. 2d, § 52.


650. But cf. 20 R. Hamilton, Texas Business Organizations § 804 (Supp. 1974), indicating that certificate holders are to be treated as other beneficial owners insofar as inspection rights are concerned. But this is not completely accurate, as a fair reading of section F and its Model Act source will show.

651. Technically, there may not be the division of ownership between legal and equitable title as in a trust when a customer's shares are held by a broker in his street name, but rather either an agency or pledge relationship, depending on whether the shares are being thus carried as a matter of convenience or have been hypothecated in a margin account. See Henn 361.
tions for an improper refusal is to discourage a potential strike suiter from buying a share or two of stock in order to start fishing immediately for a potential basis for litigation; therefore, a classification designed to accomplish that objective rather than one based on the form of beneficial ownership would make far more sense.

Finally, note should be taken that article 2.44 is not the only statutory source for the shareholder's inspection right. For example, other provisions of the TBCA give the shareholder the right to inspect the list of shareholders entitled to vote at a forthcoming meeting or to examine the counterparty of any voting trust agreement or voting agreement required to be deposited with the corporation. And, under the 1973 amendments, there are other documents he may inspect such as a written agreement among any member of shareholders and the corporation imposing restrictions on the transfer or registration of transfer of securities or an agreement among all the shareholders of a defined close corporation sanctioned by article 2.30-2 that has been set out or incorporated by reference in the bylaws, as well as the applicable bylaw. Moreover, if the legend on the share certificate so states, the shareholder may upon written request to the corporation at its registered office or principal place of business be furnished with a copy of (1) any provision of the articles of incorporation (a) setting out the designations, preferences, limitations and relative rights of each class of shares or variations in the relative rights and preferences of each series of shares if there are any; (b) limiting or denying preemptive rights; or (c) in the case of a defined close corporation, giving shareholders an option to dissolve the corporation; (2) any document imposing restrictions on the transfer of securities or (3) any agreement among all the shareholders of a defined close corporation or a bylaw of which it has been made a part.

652. TEX. BUS. CORP. ACT ANN. art. 2.27(A) (1956).
653. Id. art. 2.30(A).
654. Id. art. 2.30(B). Interestingly, the counterpart of a voting trust agreement must be filed at the corporation's principal office. By contrast, the 1973 amendments, referred to in notes 655-61 infra, require the deposit of counterparts of documents at, or requests for copies of such or other documents to be made to, the corporation's registered office and principal place of business. Contrast also TEX. BUS. CORP. ACT ANN. arts. 5.12(B) and 5.16(E)(4) (Supp. 1974), laying venue for a dissenter's appraisal action in the county where the principal office is located, with id. arts. 2.30-3(A) and 2.30-4(A) (Supp. 1974), placing venue for actions to preserve a defined close corporation's status or to seek appointment of a provisional director of such a corporation in the county where the principal place of business is located. Presumably in all these statutes, principal office and principal place of business should mean the same. The former term is undoubtedly derived from TEX. REV. CIV. STAT. ANN. art. 1995, subd. 23 (1964) (permitting venue to be maintained against domestic corporations, inter alia, "in the county in which its principal office is situated," a location sometimes described as the corporation's "domicile," see Vines v. Harry Newton, Inc., 445 S.W.2d 260, 265 (Tex. Civ. App.—Houston 1969), error dismissed), whereas the latter is derived from TEX. BUS. CORP. ACT ANN. art. 2.09(A)(1) (1956) stating that the registered office can but need not be the same as its place of business.
655. TEX. BUS. CORP. ACT ANN. art. 2.19(B) (Supp. 1974).
656. Id. art. 2.30-2(B).
657. Id. art. 2.19(B)(1).
658. Id. art. 2.19(B)(2).
659. Id. art. 2.30-5(B).
660. Id. art. 2.19(G)(3).
661. Id. art. 2.30-2(C).
Outside the TBCA, the general tax statutes likewise permit a shareholder to examine his corporation's annual franchise tax returns filed with the comptroller of public accounts.662

Shareholders' Derivative and Other Actions. The principal weapon a minority shareholder can wield to be certain that management adheres to its fiduciary duties and responsibilities has long been the derivative action in which the shareholder sues to enforce a corporate claim the directors will not prosecute, often because it lies against themselves.663 While the derivative suit is recognized in Texas,664 much of the law relating to the action has remained uncertain. There are at least two reasons for this unsettled state of affairs.

First, and somewhat surprisingly considering the large growth in corporate enterprises over the past few decades, there has been very little derivative litigation in this state.665 As a consequence, the Texas courts have had few opportunities to formulate or decide upon the characteristics of, or requirements for, the action here.

Secondly, the statutory law has not been very helpful. Unlike its present federal counterpart,666 the Texas rule speaks only of certain class actions that are "joint, or common or secondary in the sense that the owner of the primary right refuses to enforce that right and a member of the class thereby becomes entitled to enforce it."667 The primary effect of this categoriza-

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662. TEX. TAX.-GEN. ANN. art. 12.10 (1969). Any bona fide shareholder owning one or more shares can examine the reports upon presentation of evidence of ownership to the Comptroller, but apparently the information gained cannot be disclosed or used except in the course of a judicial proceeding to which a bona fide shareholder is a party. Improper disclosure can constitute a misdemeanor punishable by a fine up to $1,000 or confinement in jail not in excess of one year or both. Id. art. 12.10A (Supp. 1974).


665. 20 R. HAMILTON, TEXAS BUSINESS ORGANIZATIONS § 832, at 352; Comment, supra note 664, at 641 n.2.


667. TEX. R. CIV. P. 42(a)(1). The Texas rule is derived from federal rule 23, before its amendment; however, a section dealing with secondary actions by shareholders contained in the original federal rule as rule 23(b), see J. MOORE, supra note 666, ¶ 23.01[1], although made part of the Texas rule when first adopted, was deleted by amendment in 1941, "because it was thought to apply to a jurisdictional mischief applicable to the Federal courts and inapplicable to the Texas courts." Stayton, The New Rules: Analysis of Changes, 4 TEX. B.J. 667 (1941). There appears to have been no
tion of the derivative suit as a class action is to require the court's approval before one is dismissed or compromised. The TBCA up until 1973 furnished very little more guidance. A shareholder was authorized to bring a representative suit, as it was termed, against incumbent or former officers and directors for having engaged in acts that were ultra vires or contravened limits placed on their authority in the articles of incorporation. In 1965 a security for expenses statute was added to the Act that in essence required a plaintiff in a derivative suit to secure the corporate defendant for reasonable expenses, including attorneys' fees, of its own or of other defendants that were indemnifiable, unless he owned shares of a required percentage or value. Its purpose ostensibly was to curtail so-called "strike" suits, although given the paucity of such litigation in Texas that had hardly seemed a problem before, and was justly criticized for not discriminating between such suits and legitimate shareholders' actions.

But beyond these two provisions nothing more was said. The net result was that Texas law remained in doubt as to such aspects of derivative litigation as the need for making a demand on the shareholders if the directors would not sue whether the shareholder was re-

discussion of the rule by the Texas courts in conjunction with shareholders' derivative suits. See Tex. R. Ann., rule 42 (1967); 1 R. McDonald, Texas Civil Practice § 3.34.1, at 344 (rev. vol. 1965).

668. In a sense, a derivative action is a type of class suit in that the plaintiff usually also represents all other shareholders similarly situated who are indirectly affected by the corporation's failure to prosecute its cause of action. At the same time, the shareholder may bring a class action to enforce an individual right that also belongs to other members of his class, such as a suit to compel the declaration of dividends on preferred shares or rescind an improper issuance of shares to insiders. In such cases, both are also representative suits, a term used in the TBCA art. 2.04(B)(2). The distinction between derivative suits which are always representative and those direct actions to enforce individual rights which may not be is not always easy to draw and is often confusing, yet is exceedingly important in view of the varying procedural consequences involved. See generally 20 R. Hamilton, Texas Business Organizations §§ 831-33; Henn 755; 2 Hornstein § 601.

669. Tex. R. Civ. P. 42(b).


672. To avoid posting security for expenses, the complaining shareholder or shareholders had to own, if the corporation's stated capital were $250,000 or less, either 2% or more of the outstanding shares or shares having a market value of at least $25,000; if the stated capital exceeded $250,000, the necessary percentage and market value rose to 5% or $50,000, respectively. See 20 R. Hamilton, Texas Business Organizations § 838.


675. A few earlier Texas cases indicated by way of dictum that a demand on the shareholders is needed as well, but did not distinguish between the demand on directors
quired to have owned his shares at the time the wrong complained of occurred, the so-called "contemporaneous ownership" rule, or the types of defenses that could be asserted in such actions.\textsuperscript{677}

With the adoption of a 1973 amendment on derivative suits that completely supplants the former article on security for expenses,\textsuperscript{678} the law relating to these actions has been greatly clarified. While partly derived from the Model Act,\textsuperscript{679} the Texas amendment is a superior version both from the standpoint of balance and drafting and might well serve as a guide to other states in its treatment of the security for expenses problem.\textsuperscript{680}

The amendment begins by defining a derivative suit simply as one "brought in the right of a domestic or foreign corporation."\textsuperscript{681} Expenses are defined as those that are reasonably incurred in the defense of a deriv-
ative suit, including fees of attorneys, and for which a corporate defendant might be required to indemnify another defendant.\(^{682}\)

Next the prerequisites the plaintiff must satisfy to bring the suit are set out. First, and perhaps most importantly, he must have been a holder of shares at the time of the transaction of which he complains unless his shares devolved upon him by operation of law from a person who was an owner at that time.\(^{683}\) Thus whatever doubts there have been concerning this requisite have been resolved\(^{684}\) by adding Texas to the growing list of jurisdictions that require contemporaneous ownership.\(^{685}\) Moreover, the right to bring the action is not limited to a holder of record, but can also be exercised by an owner of a beneficial interest in a voting trust or, in a departure from the Model Act\(^{686}\) but in accord with the majority rule,\(^{687}\) by any other beneficial owner at the time.\(^{688}\) Secondly, the plaintiff's petition must state both the nature of his ownership and describe with particularity the efforts he has made to get the board of directors to bring the suit or else the reasons why such efforts were not made.\(^{689}\) Since in most cases the derivative action is brought against the board or principal officers, this requirement remains a largely formal one, but may be a significant barrier to the enforcement of corporate actions against third persons if the directors in the exercise of their disinterested, independent judgment have decided the corporation ought not to sue.\(^{690}\) These are the only two prerequisites listed and because of their specificity would appear to eliminate any need for showing a demand on the shareholders as well before bringing suit.\(^{691}\)

As to security for expenses, the most important change made by the amendment\(^{692}\) is that it is no longer mandatory in those cases where the complaining shareholder had held an insufficient number of shares; rather, whether it must be given the corporation or defendants\(^{693}\) at all falls within

\(^{682}\) TEX. BUS. CORP. ACT ANN. art. 5.14(A)(2) (Supp. 1974).

\(^{683}\) Id. art. 5.14(B)(1).

\(^{684}\) See text accompanying note 676 supra.

\(^{685}\) Comment of the Bar Committee to Art. 5.14, 3A TEX. REV. CIV. STAT. ANN. 140 (Supp. 1974). See 6 Z. CAVITCH, supra note 21, § 119.04[2][b], at 119-42 n.31 for a list of 27 states that by judicial decision, statute, or rule of court require share ownership at the time of the transaction complained of.

\(^{686}\) The Model Act permits holders of a beneficial interest in a voting trust to bring a derivative action, but not other beneficial owners. ABA MODEL BUS. CORP. ACT ANN. 2d, § 49.

\(^{687}\) See, e.g., 6 Z. CAVITCH, supra note 21, § 119.04[2], at 119-39 n.26; 13 W. FLETCHER, CYCLOPEDIA CORPORATIONS § 5976; HENN 762; 2 HORNSTEIN 193; LATTIN 421; Note, Rights of Equitable Owners of Corporate Shares, 99 U. PA. L. REV. 999 (1951).

\(^{688}\) TEX. BUS. CORP. ACT ANN. art. 5.14(B)(1) (Supp. 1974).

\(^{689}\) Id. art. 5.14(B)(2).


\(^{691}\) 20 R. HAMILTON, TEXAS BUSINESS ORGANIZATIONS § 836 (Supp. 1974).

\(^{692}\) TEX. BUS. CORP. ACT ANN. art. 5.14(C) (Supp. 1974).

\(^{693}\) The amendment permits the court to require security not only for the corporation's defenses but for any expenses "incurred or expected to be incurred by one or more of the defendants." This, however, makes no substantive change since under the former version, the security the corporation could require to be posted could also cover attorneys' fees of other parties to the action which the corporation would be obligated to in-
the discretion of the court having jurisdiction of the suit.694 The court retains the power, as before, to increase or decrease the amount of security if a showing is made that it is inadequate or excessive;695 the court may also excuse a plaintiff unable to give security because of poverty if an affidavit is filed in accordance with the Texas Rules of Civil Procedure696 stating that he is too poor to pay costs and give security for expenses.697 If the plaintiff fails to give security within a reasonable time set by the court, the suit may be dismissed without prejudice.698 Finally, and in what may be the most significant barrier of all to baseless actions or strike suits (and rightly so), the court may, upon final judgment for one or more of the defendants and a finding that the suit has been brought without reasonable cause, award expenses to such defendants, whether security for expenses has been required or not.699 As a corollary, this means that if the action is settled by dismissal700 or without a judgment for the defendants, or if the court decides not to require the plaintiff to pay expenses, such expenses cannot be recovered by the defendants since the statute no longer speaks in terms of the corporation having a right of reimbursement from any security formerly required to be given.701 Nothing is said of the winning plaintiff's right to recover attorneys' fees and expenses on the theory that the corporation has been benefited because of his initiative and efforts;702 in the view of the Bar Committee, this right is so well-established under common law and equitable

demnify. The present statute covers such indemnifiable expenses in the definition of expenses in section (A)(2)(b), see note 682 supra; however, in the sense that such indemnifiable expenses may go beyond counsel fees, the difference in language may result in greater security having to be posted under the amended article than formerly.

694. The amendment does not state what factors should influence the court in making its decision on whether security for expenses should be given or not. Professor Hamilton believes the court would likely consider the probability that the plaintiff will be ordered to pay the expenses of one or more of the defendants under section F if it suspects the action has been brought without reasonable cause, and depending on whether the plaintiff has sufficient assets that creditors can reach to satisfy the order. 20 R. HAMILTON, TEXAS BUSINESS ORGANIZATIONS § 838, at 36 n.39 (Supp. 1974). The Bar Committee suggests that in exercising its discretion the court may consider the pleadings, affidavits, or other data, or hold a preliminary hearing if it desires more information. Comment of Bar Committee to Art. 5.14, 3A TEX. REV. CIV. STAT. ANN. 140 (Supp. 1974).

695. TEX. BUS. CORP. ACT ANN. art. 5.14(C) (Supp. 1974).
696. TEX. R. CIV. P. 145.
697. TEX. BUS. CORP. ACT ANN. art. 5.14(D) (Supp. 1974).
698. Id. art. 5.14(E).
699. Id. art. 5.14(F). The provision is taken from the Model Act. ABA MODEL BUS. CORP. ACT ANN. 2d, § 49 (second paragraph). See Comment, supra note 664, at 649, where the author contended as early as 1958 that this provision rather than security for expense legislation or the contemporaneous ownership requirement would serve as the more effective deterrent of strike suits.


701. The operative words of the former statute stated: "[T]he corporation in whose right such action is brought shall be entitled . . . to require the complainant . . . to give security for the reasonable expenses . . . which may be incurred by it in connection with such action . . . to which the corporation shall have recourse in such amount as the court . . . shall determine upon the termination of such action." Ch. 332, § 1, [1965] TEX. LAWS 698-99. See 20 R. HAMILTON, TEXAS BUSINESS ORGANIZATIONS § 838, at 358.

principles that it did not require codification.\textsuperscript{703} Of course, the same thing can be said concerning the requirement for a demand on the directors and perhaps in the interests of even more balance, the statute should have addressed itself to this side of the coin. On the other hand, since the award and size of counsel fees are so dependent on the circumstances of each case,\textsuperscript{704} any parameters set by statute may not prove useful.

Because the requisites have now been mandated by statute for derivative suits, the need for differentiating such actions from individual or other class actions, not encumbered by such requirements, becomes all the more important.\textsuperscript{705} Another 1973 amendment, for example, permits a shareholder to bring a direct action to enjoin the making of a guaranty on the ground it could not reasonably be expected to benefit his guarantor corporation, either directly or indirectly;\textsuperscript{706} however, once the guaranty has been made, his recourse then must be a representative (read: derivative) suit against the directors who voted for or assented to the making of the guaranty.\textsuperscript{707} The distinction between the various actions a shareholder can bring was also emphasized in a federal diversity case arising in Texas during the survey period.\textsuperscript{708} Under the facts, a Texas insurance company loaned $350,000 to a North Dakota corporation, secured by 50,000 shares in National Insurance Company, which later came under the Texas company’s control. When the note was not paid, the Texas company sold the collateral to itself for $150,000, a value considerably less than its alleged worth at the time it was given for security, and sued the North Dakota company for the deficiency. The defendant attacked the validity of the foreclosure sale\textsuperscript{709} and counterclaimed on the basis that the Texas plaintiff had used its control over National to so dissipate its assets as to violate its duty as pledgee not to intentionally deplete the value of the collateral which it held. The trial court dismissed the counterclaim, apparently on the ground that it was essentially a shareholder’s suit for mismanagement which should have been brought derivatively. The Fifth Circuit ruled this was error, reasoning that where the action complained of creates not only a cause of action in favor of the corporation but also one for the shareholder arising out of a duty owed to him as an individual (in this case the duty owed by the pledgee to the pledgor to preserve the value of the collateral

\textsuperscript{705} See note 668 supra.
\textsuperscript{707} Id.
\textsuperscript{708} Empire Life Ins. Co. v. Valdak Corp., 468 F.2d 330 (5th Cir. 1972).
\textsuperscript{709} The trial court’s decision on this point was reversed and remanded because it had erroneously applied the standards of the Uniform Commercial Code in deciding whether a deficiency judgment should be granted in that the loan transaction had been consummated prior to the effective date of the Code in either Texas or North Dakota, the two states concerned. \textit{Id.} at 334.
pledged),\textsuperscript{710} he may sue in his individual capacity.\textsuperscript{711} The case perhaps illustrates the scarcity of Texas law on the subject since only one Texas decision was cited out of many\textsuperscript{712} and it is obvious it was decided on the basis of general common law in point, \textit{Erie} notwithstanding.

\textit{Preemptive Rights}. The preemptive right is generally regarded as another of the fundamental rights shareholders enjoy,\textsuperscript{713} yet in reality it is more often denied than not in most publicly held corporations.\textsuperscript{714} A creature of the American courts,\textsuperscript{715} the right may be defined as the opportunity given a shareholder to acquire a proportional share of any new issue of stock being sold to raise additional capital so that his relative status in the corporation in regard to voting power, payment of dividends, or distribution of assets on liquidation can be preserved, if he wishes.\textsuperscript{716} Its premise is that as owners of the corporate enterprise, shareholders should have the privilege of maintaining their proportionate ownership in the corporation on equal terms with each other and in preference to strangers.\textsuperscript{717} The right, however, is not absolute. Over the years, the courts have carved out various exceptions in the process of accommodating the differing objectives for which shares are issued. Thus while the right is almost always recognized when newly authorized shares are being sold for cash,\textsuperscript{718} it does not extend to the issuance of shares to acquire property,\textsuperscript{719} effect a merger or

\textsuperscript{710} \textit{Id.} at 335.

\textsuperscript{711} The court treated this as an exception to the general rule that a shareholder cannot sue in his own right for the general diminution in the value of his shares caused by mismanagement. \textit{Id.} at 335. The rule it stated is well established. \textit{See, e.g., 20 R. Hamilton, Texas Business Organizations} § 833; 2B Hornstein 99.


\textsuperscript{714} 11 W. Fletcher, Cyclopedea Corporations} § 5135 (perm. ed. rev. repl. 1971).

\textsuperscript{715} The preemptive right is said to have been first recognized in Gray v. Portland Bank, 3 Mass. 364, 3 Am. Dec. 156 (1807), although there is some dispute as to whether preemptive rights were involved in that case. \textit{See Drinker, supra note 713, at 590-93. The English courts, however, have not recognized the right as one inhering in shareholders unless otherwise abrogated. Gower, \textit{Some Contrasts Between British and American Corporation Law}, 69 Harv. L. Rev. 1369, 1380 (1956).}

\textsuperscript{716} \textit{Cf. Cary 1133; Lattin 493. For other definitions see Gord v. Iowana Farms Milk Co., 245 Iowa 1, 15, 60 N.W.2d 820, 828 (1953); Ross Transp., Inc. v. Crothers, 185 Md. 573, 581-82, 45 A.2d 267, 270 (1946); Bonnet v. First Nat'l Bank, 60 S.W. 325, 326 (Tex. Civ. App. 1900), error disallowed; Fuller v. Krogh, 15 Wis. 2d 412, 420, 113 N.W.2d 25, 31 (1962).}

\textsuperscript{717} Miles v. Safe Deposit & Trust Co., 259 U.S. 247, 252 (1922); Gord v. Iowana Farms Milk Co., 245 Iowa 1, 15, 60 N.W.2d 820, 828 (1953).

\textsuperscript{718} \textit{E.g., Gord v. Iowana Farms Milk Co., 245 Iowa 1, 15, 60 N.W.2d 820, 828 (1953); Gray v. Portland Bank, 3 Mass. 364, 3 Am. Dec. 156 (1807); Stokes v. Continental Trust Co., 186 N.Y. 285, 299, 78 N.E. 1090, 1094 (1906).}

\textsuperscript{719} \textit{E.g., Rogers v. First Nat'l Bank, 410 F.2d 579 (4th Cir. 1969); Hodge v. Cuba...
Compromise a debt,270 pay for needed services,272 or carry out a plan or reorganization under the federal bankruptcy law.273 Even when shares are issued for cash, some uncertainty exists as to whether the right applies if the shares sold are treasury shares or those originally authorized when the corporation was formed but not yet issued. Most courts refuse to recognize the right with reference to treasury shares,274 but, under modern authority at least, will enforce it as to the subsequent issuance of the originally authorized shares, especially when a much larger number of shares was authorized than originally issued in obvious contemplation of being used for future financing.275 If the corporation has more than one class of shares, the status of the right becomes more confusing, depending upon the impact the issue of additional shares of another or entirely new class will have on the relative rights of other classes.276 It was largely the complexities of applying the right in multi-class securities capitalization as well as the desire to give management a freer hand in financing that led to the modern legislation which limits or curtails the right or denies it entirely unless authorized in the articles.277 Finally, there is no requirement that when the right does exist the shareholder be allowed to purchase the shares at par if less than market value278 or prevent the sale of his proportionate part of the issue if he is financially unable to acquire his allotment.279 So long as the directors act fairly and reasonably and in accord

Co., 142 N.J. Eq. 340, 60 A.2d 88 (Ch. 1948); Meredith v. New Jersey Zinc & Iron Co., 55 N.J. Eq. 211, 37 A. 539 (Ch. 1897), aff'd, 56 N.J. Eq. 454, 41 A. 1116 (Ct. Err. & App. 1897). But cf. Fuller v. Krogh, 15 Wis. 2d 412, 113 N.W.2d 25 (1962) (preemptive right should not be denied when stock issued for property unless corporation has great need for same and acquisition for stock only practical and feasible method of obtaining it).


725. See generally ABA Model Bus. Corp. Act Ann. 2d, § 26A, ¶ 2; 6 Z. Cavitch, Business Organizations § 115.01[2].


727. See generally Lattin 493.

728. See generally 6 Z. Cavitch, Business Organizations § 115.01[2].

729. E.g., Bellows v. Porter, 201 F.2d 429 (8th Cir. 1953); Hyman v. Velsicol Corp., 342 Ill. App. 489, 97 N.E.2d 122 (1951); Maguire v. Osborne, 388 Pa. 121, 130 A.2d
with their fiducial duties and responsibilities in fixing the price and conditions under which the right is to be exercised, the shareholder cannot complain.\textsuperscript{730}

Until 1973, the dimensions of the preemptive right had not clearly been determined in Texas.\textsuperscript{731} The TBCA as originally enacted recognized the right as one that could be limited or denied in the articles of incorporation\textsuperscript{732} or an amendment thereto,\textsuperscript{733} but except for extending the right to both treasury and authorized but unissued shares,\textsuperscript{734} requiring that any limitation or denial be appropriately noted on the share certificates,\textsuperscript{735} and allowing shares to be sold to officers and employees when authorized by the holders of two-thirds of the voting shares,\textsuperscript{736} neither the nature of the right nor the other exceptions to its exercise were touched upon. These matters had to be determined on the basis of case law and that consisted of the grand total of one early civil appeals opinion, \textit{Bonnet v. First National Bank}.\textsuperscript{737}

The \textit{Bonnet} case recognized the preemptive right but also acknowledged its judge-made limits insofar as treasury shares and shares issued for property were concerned,\textsuperscript{738} holding specifically that the right did not apply to a merger-type transaction.\textsuperscript{739} Given this scarcity of authority, it could only be assumed that Texas would follow the common law concept of the rule except as modified by the TBCA.\textsuperscript{740} Now, with the addition of a new article on preemptive rights, this assumption has been largely confirmed.

The new article,\textsuperscript{741} much of which is derived from an alternative provision

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of the Model Act\textsuperscript{442} designed for state acts such as the TBCA that confer the right unless denied or limited\textsuperscript{443} rather than as granted in the articles,\textsuperscript{444} states that the preemptive right "shall be only the opportunity to acquire shares or other securities under such terms and conditions as the board of directors may fix for the purpose of providing a fair and reasonable opportunity for the exercise of such right."\textsuperscript{445} As so defined, the right applies not only to unissued, additional, and treasury shares, as before, but also to convertible securities or any warrants, options, or other subscription rights to acquire shares.\textsuperscript{446} On the other hand, the new statute significantly limits the right by codifying in essence most of the common law exceptions. Thus, unless the articles otherwise provide, no preemptive right exists to acquire shares sold for other than cash\textsuperscript{747} or that have been issued to employees upon approval by the holders of a majority of the voting shares or pursuant to a plan permitting such purchases previously approved in the same manner.\textsuperscript{748} The latter provision changes the law in several respects. First, the range of securities that can be sold to employees free of preemptive

\textsuperscript{2.22-1 (Supp. 1974).} The provisions relating to preemptive rights that had formerly been part of article 2.22-1 (Supp. 1974) were placed in a separate article both because of the length of article 2.22 as amended in 1973, and to be consistent with the Model Act which treats preemptive rights in a separate section. Comment of Bar Committee to Art. 2.22-1, \textit{Tex. Rev. Civ. Stat. Ann.} 65 (Supp. 1974); Doty & Parker 1017.

\textsuperscript{742.} ABA \textit{Model Bus. Corp. Act} Ann. 2d, § 26A. The provision is an alternative to section 26 of the Model Act which denies the preemptive right except as conferred in the articles of incorporation. At the time of the adoption of the TBCA, the 1953 revision of the Model Act contained only a single section that recognized the right unless denoted in the articles and it was this section that became article 2.22(C) of the TBCA. In 1955 the ABA Committee on Corporate Laws adopted an alternative provision restricting the right unless conferred. 1 ABA \textit{Model Bus. Corp. Act} Ann. § 24 (1960). By the time of the 1969 revision of the Model Act, its draftsmen, in order to accord with "the modern trend of practice," decided to make the restrictive provision the primary section and the section recognizing the right an alternative one. 1 ABA \textit{Model Bus. Corp. Act} Ann. 2d, §§ 26, 26A, at 533. Since relatively few states prohibit the right unless conferred in the articles, see note 744 \textit{infra}, it is hard to discern a trend in the statutes unless the ABA draftsmen assumed that once Delaware made the change recognizing the right to denying it absent a charter provision to the contrary, as it did in 1967, see E. Polk, \textit{supra} note 194, at 11, the great majority of states were bound to follow. Thus far, very few have.


\textsuperscript{746.} Id. art. 2.22-1(A).

\textsuperscript{747.} Id. art. 2.22-1(B)(1)(b).

\textsuperscript{748.} Id. art. 2.22-1(B)(1)(a).

rights has been expanded as the former provision spoke only of "treasury or unissued shares." 749 Secondly, the shareholders’ vote for approval has been reduced from two-third to a majority vote. 750 Thirdly, the new article refers only to shares issued to employees, whereas the old law permitted sales to "officers or employees or employees of any subsidiary corporation." 751 Although officers are sometimes considered employees, 752 especially in so-called employee stock option or purchase plans, 753 their omission in the new statute seems deliberate, especially since the Model Act source for this provision denies the preemptive right to shares issued to "directors, officers or employees" pursuant to shareholder approval. 754 The omission is consistent with the policy underlying the limitation of a corporation’s power to lend money or guarantee the obligations of its directors or officers; 755 on the other hand, the TBCA also gives the corporation power to fix the compensation of its officers 756 and to establish stock bonus plans "and other incentive plans" for them, as well as for employees. 757 Nevertheless, since it appears shareholders will have a preemptive right to shares offered to officers for cash either directly or according to a previously approved plan, the solution, if a stock incentive for executives is desired, is to specifically limit or deny the right as to such sales in the articles. A similar provision would have to be adopted to cover sales of the parent’s stock to employees of its subsidiaries.

To simplify matters when there are several classes of stock, the new article flatly denies the right to holders of preferred or other limited classes of stock, unless the articles otherwise provide. 758 This means that there is no right to acquire even other shares of the class of preferred, 759 although pre-

749. Ch. 64, art. 2.22(D), [1955] Tex. Laws 253.
750. TEX. BUS. CORP. ACT ANN. art. 2.22-1(B)(1)(a) (Supp. 1974). In both versions, only shareholders having voting rights needed to approve the issuance. Under the former provision, the shareholder could delegate authority to the directors to issue the shares if approved by the proper percentage; under the new statute, the shares may also be issued when authorized by and consistent with a plan previously approved by the vote of the holders of a majority of the shares. The difference in language seems more a change in form than in substance.
751. Ch. 64, art. 2.22(D), [1955] Tex. Laws 253.
754. ABA MODEL BUS. CORP. ACT ANN. 2d, § 26A.
755. TEX. BUS. CORP. ACT ANN. arts. 2.02(A)(6), 2.41(A)(4) (1956).
756. TEX. REV. CIV. STAT. ANN. art. 1302-2.06(B) (Supp. 1974); see discussion in text accompanying note 133 supra.
757. TEX. BUS. CORP. ACT ANN. art. 2.02(A)(12) (1956).
758. Id. art. 2.02(A)(17).
759. TEX. BUS. CORP. ACT ANN. art. 2.22-1(B)(4) (Supp. 1974).
760. The rights of holders of preferred or special classes of shares to purchase additional shares of common or of the same or other classes of preferred have not been fully developed by case law. A critical factor seems to be whether holders of preferred have the right to participate in the distribution of net assets upon dissolution or have general voting rights. Compare Thomas Branch & Co. v. Riverside & Dan River Cotton Mills, 139 Va. 291, 123 S.E. 542 (1924); id., 147 Va. 522, 137 S.E. 614 (1927) (recognizing
ferred has some protection in its right to a class vote if the shares to be offered must first be authorized by an amendment to the articles. This denial is not likely to be of great consequence when the shares are publicly-held and if so regarded, can be provided against in the protective provisions of the preferred share contract, but it may have serious consequences in the close corporation where it may definitely affect a participant's relative position if such shares are being used to give some of the contributors of venture capital a priority in distribution of income or assets on liquidation or is being employed for tax purposes or to shift control in a family corporation. The answer here of course is to provide for the right in the articles.

On the other side of the coin, common shareholders also have no preemptive rights to preferred or other limited classes or obligations unless such securities are convertible into common or carry a right to subscribe to or acquire common shares. In addition, if there is more than one class of common, one with voting power and one without, the holders of the latter have no preemptive right to acquire the voting common.

As the foregoing discussion makes evident, careful consideration must be given to the preemptive right in corporation planning. In particular, clients must decide whether they want to modify or eliminate the right to the extent it remains exercisable under the new amendment or conversely, to grant the right as to any issuances of shares now statutorily excluded from its application. Generally, availability of the right can be a hindrance to equity financing in corporations whose securities are or will be publicly traded, especially when there are several classes of securities, some of which are convertible into voting common. In such circumstances, either the promoters or later, management, will want to abolish the right. But care should be taken in doing so not only to properly draft an appropriate provision in the articles of incorporation but also to be certain that the share

preemptive rights of holders of class preferred as to dividends but without a liquidation preference and apparently having voting rights to issue of new common), with General Inv. Co. v. Bethlehem Steel Corp., 88 N.J. Eq. 237, 102 A. 252 (Ch. 1917) (holders of preferred with liquidation preference have no preemptive right to new issue of non-voting prior preferred shares). See generally Cary 1167; 11 W. Fletcher, Cyclopedia Corporations § 6136.3 (perm. ed. rev. repl. 1971); Hills, Preemptive Right of Preferred Stockholders To Subscribe to New Stock, 5 N.Y.U.L. Rev. 207 (1927); Note, Preferred Stockholder's Right of Preemption, 26 Harv. L. Rev. 75 (1912).


See, e.g., Buxbaum, supra note 278, at 293.


Id. art. 2.22-1(b)(4).

See, e.g., 6 Z. Cavitch, Business Organizations § 115.01[1], at 287; Lattin 494.

certificates carry the legend prescribed by another of the 1973 amendments. Presumably since preferred has no preemptive right at all unless conferred by the articles, there is no need for such a legend on its certificates.

On the other hand, the preemptive right may be an important ingredient in a close corporation relationship since normally each participant wants some assurance his relative status as to voting or participation in earnings is not diluted by the issuance of additional shares. If the corporation is a defined one managed by its shareholders, the need for preserving the right is all the more acute, particularly since the statute now specifies a variety of situations where it does not exist if not otherwise provided for. Consequently, in the process of setting up a close corporation, the various circumstances under which shares may be issued in the future and the impact of the preemptive right as presently defined and limited should be explored with the clients and care taken to spell out those facets of the right they want preserved or limited in the articles. If the corporation qualifies as a defined close corporation and all the shareholders agree, the dimensions of the right thus worked out can also be protected by an agreement under article 2.30-2, under the broad authorization conferred by that statute. Even if dealt with in such an agreement, it would be wise to provide for the right in the articles as well in view of the specific language of the new statute. Moreover, once inserted in the articles, further safeguards may then be needed to prevent the provision from being later amended or repealed over the objections of the shareholders whose interests are sought to be protected from subsequent dilution. Clearly one answer is to give them a veto power over any such amendment or repeal by use of high quorum or voting percentages for shareholder action, especially if classification of shares is also being employed.

768. TEX. BUS. CORP. ACT ANN. art. 2.19(B)(2) (Supp. 1974). The limitation or denial of preemptive rights to acquire unissued or treasury shares (and presumably of additional shares) must be set out on the face or back of the share certificate or else must be stated thereon (although the statute does not say so specifically due to an oversight in drafting) that the corporation will furnish a copy of the limitation or denial to any shareholder on request made to the corporation's principal office and that the same can also be found on file in the secretary of state's office.

769. See, e.g., 6 Z. CAVITC, BUSINESS ORGANIZATIONS § 115.01[1], at 283; C. ISRAELS, supra note 767, at 157; 2 HORNSTEIN 151; 1 F. O'NEAL, CLOSE CORPORATIONS §§ 3.39, 8.09; W. PAINTER, CLOSELY HELD CORPORATIONS 142, 432; Campbell, supra note 767, at 158, reprinted in 3A TEX. REV. CIV. STAT. ANN. 585 (1956).

770. TEX. BUS. CORP. ACT ANN. art. 2.30-1(B) (Supp. 1974); see discussion in text accompanying note 535 supra.

771. Id. art. 2.30-2(A). The shareholders' agreement this article sanctions may regulate the relations of the shareholders, as well as any phase of the business and affairs of the corporation, including any arrangement among the relations of the shareholders and the corporation that would otherwise be appropriate in a partnership. Id. art. 2.30-2(A)(8). See discussion in text accompanying notes 537-43 supra.

772. See 2 HORNSTEIN 152.


774. Cf. Shanken v. Wolfman, 370 S.W.2d 197 (Tex. Civ. App.—Houston 1963), error ref. n.r.e. (shareholder owning all of one class of shares equal to one-third of outstanding shares unable to prevent amendment to articles increasing numbers of shares of other two classes held by other two shareholders).
Right To Dissent. One of the many innovations the TBCA introduced into Texas' corporation law was recognition of a new shareholder's right, the right to dissent. In essence, the right allows a minority shareholder who properly and timely objects to certain fundamental transactions that significantly alter the corporation's structure to have his shares repurchased by the corporation, either on the basis of an agreed price or, if necessary, by resort to litigation to have their fair value appraised and adjudged. Because the right is always accompanied by the appraisal remedy it is sometimes referred to as the shareholder's right of appraisal. Under the original TBCA, the right to dissent existed as to three types of corporate actions: (1) an amendment substantially altering or changing the corporation's purpose; (2) any plan of merger or consolidation to which the corporation was a party; and (3) a sale, lease, exchange or similar disposition of all or substantially all of the corporation's assets requiring shareholder approval under the Act. In most states, mergers and sales of assets are the usual grounds for granting dissenters the appraisal remedy. But very few recog-

775. Although Dean Hildebrand stated that a dissenting shareholder could recover the value of his shares independently of statute in the case of a consolidation, 3 L. HILDEBRAND, TEXAS CORPORATIONS § 990, at 562, it is generally agreed the right is one that must be conferred by statute and was not available in Texas until adoption of the TBCA. Massey v. Farnsworth, 333 S.W.2d 262, 266 (Tex. Civ. App.—Houston 1962), rev'd, 365 S.W.2d 1 (Tex. 1963); 20 R. HAMILTON, TEXAS BUSINESS ORGANIZATIONS § 911; Wolf, Dissenting Shareholders: Is the Statutory Appraisal Remedy Exclusive?, 42 TEXAS L. REV. 58, 63 (1965); cf. Belsheim, The Need for Revising the Texas Corporation Statutes, 27 TEXAS L. REV. 659, 693 (1949); 4 BAYLOR L. REV. 111, 115 (1951). The case relied upon by Dean Hildebrand to support his statement, International & G.N.R.R. v. Bremond, 53 Tex. 96 (1880), permitted the dissenting shareholder to recover the value of his shares because, there being no statutory basis for the consolidation, unanimous shareholder consent was required for its consummation. By contrast, the TBCA procedure presupposes a validly authorized corporate action. Wolf, supra, at 63.

See generally on the right to dissent 6 Z. CAVITCH, BUSINESS ORGANIZATIONS §§ 112.01-04; 13 FLETCHER, CYCLOPEDIA CORPORATIONS §§ 5906.1-17 (perm. ed. rev. repl. 1970); 20 R. HAMILTON, TEXAS BUSINESS ORGANIZATIONS §§ 911-17; HENN § 349; 2 HORNSTEIN §§ 629-34; LATTIN 591.

776. If the dissenting shareholder and corporation cannot agree, either may initiate the proceeding seeking judicial determination of the fair value of the shares. TEX. BUS. CORP. ACT ANN. art. 5.12(B) (Supp. 1974). Once a shareholder has filed suit, the corporation may then join all shareholders who have demanded payment for their shares and who, if properly notified, will then be bound by the court's final judgment. Id. In the absence of fraud in the transaction, the appraisal remedy is the exclusive mode for a dissenter to recover the value of his shares or money damages. Id. art. 5.12(G). As to the exclusivity of the Texas appraisal remedy see 20 R. HAMILTON, TEXAS BUSINESS ORGANIZATIONS § 917; Amsler, supra note 127, at 62; Wolf, supra note 775; Comment of Bar Committee to Art. 5.12, 3A TEX. REV. CIV. STAT. ANN. 135, 136 (Supp. 1974).

777. E.g., 6 Z. CAVITCH, BUSINESS ORGANIZATIONS § 112.01; 13 W. FLETCHER, CYCLOPEDIA CORPORATIONS §§ 5906.1 (perm. ed. rev. repl. 1970); 20 R. HAMILTON, TEXAS BUSINESS ORGANIZATIONS § 911. The Model Act uses the term "right to dissent." ABA MODEL BUS. CORP. ACT ANN. 2d, § 80, ¶ 2.

778. TEX. BUS. CORP. ACT ANN. art. 5.11 (Supp. 1974). The first ground was derived from OKLA. STAT. ANN. tit. 18, § 1.157(2) (1951); the second and third from sections 71 and 74 of the 1953 edition of the Model Act.

779. For comprehensive listings of state statutes see 6 Z. CAVITCH, BUSINESS ORGANIZATIONS § 112.02[1], at 10 n.9, § 112.02[2], at 10 n.23. While every state except West Virginia recognizes the appraisal remedy for at least some types of mergers, ten jurisdictions (Arizona, California, Delaware, Georgia, Hawaii, Kansas, Minnesota, Nevada, West Virginia, and the District of Columbia) do not afford the remedy for sales of all or substantially all the assets. ABA MODEL BUS. CORP. ACT ANN. 2d, § 80, ¶ 3.03. In some states, including Texas, a so-called short form merger between a parent and subsidiary gives only the dissenting shareholders of the subsidiary the right to demand payment for their shares. See, e.g., TEX. BUS. CORP. ACT ANN. art. 5.16 (Supp. 1974) (90% ownership). Some states also deny the right in mergers where the shares involved
nize the right as to other corporate actions such as amendments to the articles, especially one substantially changing corporate purposes as singled out in the Texas Act. Nevertheless there was a good reason for including the right to dissent for this type of amendment at the time the TBCA was adopted.

Under the old Texas law, a corporation generally could be organized only for one purpose and even that purpose had to be one authorized by statute. On the other hand, the TBCA as proposed sought to permit incorporation for any number of purposes for which general business corporations could be organized with very minor exceptions. Because of the change of policy involved, the Bar Committee believed the legislature would be more willing to accept an expanded scope of corporate activity if any shareholder who might have relied upon the old corporation law in investing in a corporation limited to a single business purpose had some assurance his investment would be returned at its current fair value once his corporation took advantage of the new law to materially change or alter its purposes over his objections. Whether this concern was well-founded or not is conjectural. As it turned out, the need for removing Texas corporations from the strait jacket of the single purpose clause proved to be one of the strongest arguments for adoption of the TBCA. Moreover, there

are listed on a national securities exchange or are held by no less than 2,000 shareholders. See, e.g., DEL. CODE ANN. tit. 8, § 262(k) (Supp. 1972); KAN. STAT. ANN. § 17-6712(k)(1) (Supp. 1973); MICH. COMP. LAWS ANN. § 450.1762 (1973); R.I. GEN. LAWS ANN. § 7-1.1-73 (1970); VA. CODE ANN. § 13.1-75 (1973). In a few jurisdictions the right to dissent is denied as to sales of assets if the proceeds are to be distributed in cash or readily marketable securities within a year of the sale. See, e.g., MICH. COMP. LAWS ANN. § 450.1761(b) (1973); N.J. STAT. ANN. § 14A:11-1(b) (Supp. 1974); S.C. CODE LAWS § 12-21.5 (Supp. 1973); TENN. CODE ANN. § 48.909(1)(b) (Supp. 1973); WIS. STAT. § 180.72(1) (Supp. 1974).

Aside from mergers, sales of assets, and adverse amendments, the only other corporate action for which the right to dissent is given in a very few states is dissolution, generally when distributions in liquidation are to be made in something other than cash. See, e.g., N.Y. BUS. CORP. LAW § 1005(a)(3)(A) (McKinney 1963); N.C. GEN. STAT. ANN. § 55-119(b) (1965); see generally 6 Z. CAVITCH, BUSINESS ORGANIZATIONS § 112.02(4). 780

Approximately 15 states recognize the right of dissent upon adoption of certain amendments to the articles. In general, the amendments are those changing the corporate purpose, extending corporate life, reducing the number of directors, or adversely affecting or changing the rights of various classes of shares. See ABA MODEL BUS. CORP. ACT ANN. 2d, § 80, ¶ 3.03(3); 6 Z. CAVITCH, BUSINESS ORGANIZATIONS § 112.02(3) for citations.

Six states allow dissent to an amendment changing corporate purposes. IDAHO CODE § 30-150 (1967); MASS. GEN. LAWS ch. 156, § 46 (1970); MINN. STAT. ANN. § 301.40 (1969); N.H. REV. STAT. ANN. § 294.76 (1966); OHO REV. CODE ANN. § 1701.74 (Page 1964); OKLA. STAT. ANN. tit. 18, § 1.157 (1953). See also N.C. GEN. STAT. ANN. § 55-101(b) (1965) (change from profit to non-profit corporation or cooperative organization).

See note 82 supra.

See note 84 supra.


have been no reported instances of the appraisal remedy being resorted to because of a change of purpose.

As previously discussed, one of the 1973 amendments now allows a corporation to state as its purpose the transaction of any lawful business for which corporations may be incorporated under the Act. Given this permitted generality of expression, it is evident the purpose clause is no longer meant to play a meaningful role in limiting the scope of the corporate enterprise (and probably has not in most corporations for years). For this reason and because in the Bar Committee's view affording the right to dissent for a change of corporate purpose has become archaic and unnecessary, this ground for exercise of the right to dissent has been repealed.

V. RIGHTS, DUTIES, AND LIABILITIES OF CORPORATE MANAGEMENT AND CONTROLLING SHAREHOLDERS

Despite the sweep of the 1973 amendments, very little was enacted that pertained to the duties and liabilities of directors, officers, or controlling shareholders. Most of the developments arose from litigation.

A. New Legislation

 Liability Insurance. As noted earlier, one of the additional powers conferred on Texas corporations in 1973 was authorization to purchase and maintain insurance on behalf of any person who is or has been a director, officer, employee, or agent of the corporation or has served in that capacity at the corporation's request in another corporation, partnership, joint venture, or trust against any liability asserted against him and incurring by him in any such capacity or arising out of his status as such, whether or not the corporation could otherwise indemnify him under article 2.02. The new provision is taken directly from the 1967 revision of the Model Act and is virtually identical to Delaware's law. It was all the Bar Committee felt it could salvage from a much more comprehensive article on indemnification, derived mainly from the same revised Model Act

788. TEX. BUS. CORP. ACT ANN. art. 3.02(A)(3) (Supp. 1974); see discussion in text accompanying notes 82-89 supra.
789. See Doty & Parker 1011; Comment of Bar Committee to Art. 2.01, 3A TEX. REV. CIV. STAT. ANN. 9 (Supp. 1974).
790. Doty & Parker 1024; Comment of Bar Committee to Art. 5.11, 3A TEX. REV. CIV. STAT. ANN. 131, 132 (Supp. 1974).
792. See text at note 102 supra.
794. ABA MODEL BUS. CORP. ACT ANN. 2d, § 5(g).
795. DEL. CODE ANN. tit. 8, § 145(g) (Supp. 1968). The coincidence of the Model Act and Delaware law is not surprising in view of the fact that the insurance provision is part of a larger statute on indemnification that was the joint product of the ABA Committee on Corporate Laws and a subcommittee of the Delaware Revision Commission. Sebring, Recent Legislative Changes in the Law of Indemnification of Directors, Officers and Others, 23 Bus. Law. 95, 96 (1967). Indeed, the ABA Committee expressed its gratification in bringing uniformity "on a subject so complex and often so confusing." Id.
section and Delaware law, that had been proposed as part of the 1973 amendment program but was dropped when some opposition developed to its more permissive terms, leaving the older and more restrictive provision on indemnification intact.

The proposed indemnification statute, which would have been added as a new article 2.02-1, was a somewhat expanded and modified version of section 5 of the Model Act, as revised in 1967. The latter replaced a much briefer provision in the general powers section of the Model Act that provided essentially for permissive indemnification of directors and officers for expenses incurred in defending litigation resulting from their being or having been a director or officer, unless there had been an adjudication of liability for negligence or misconduct. The TBCA followed the 1953 version of the section.

As proposed, and in accordance with modern legislation on indemnification, TBCA article 2.02-1 would have differentiated between third party and derivative actions by allowing recovery of judgments and fines as well as expenses in third party actions, but under prescribed conditions and standards. The statute would have also established a right to indemnification in the event of a successful defense against any civil or criminal claim made in either a third party or derivative suit. Other provisions sought to detail the mechanism for determining whether the prescribed standard of conduct permitting indemnification had been met, allow advancement and proration of expenses, make indemnification under the statute non-exclusive and continuing in nature, and require reporting to the shareholders of any payments made for indemnification or for insurance proceeds collected. S.B. 202, § 4, 63d Leg., Reg. Sess. (1973).

The Bar Committee has continued its work on an indemnification statute and at one point drafted a revised proposal to be submitted to the legislature in 1975, see Haynes, Report of Section of Corporation, Banking and Business Law, 37 Tex. B.J. 365 (1974); however, it has subsequently decided not to press for enactment before 1977.

As proposed, and in accordance with modern legislation on indemnification, TBCA article 2.02-1 would have differentiated between third party and derivative actions by allowing recovery of judgments and fines as well as expenses in third party actions, but under prescribed conditions and standards. The statute would have also established a right to indemnification in the event of a successful defense against any civil or criminal claim made in either a third party or derivative suit. Other provisions sought to detail the mechanism for determining whether the prescribed standard of conduct permitting indemnification had been met, allow advancement and proration of expenses, make indemnification under the statute non-exclusive and continuing in nature, and require reporting to the shareholders of any payments made for indemnification or for insurance proceeds collected. S.B. 202, § 4, 63d Leg., Reg. Sess. (1973).

This was not the initial criticism the Bar Committee had had of its proposal, as Professor Alan Bromberg of Southern Methodist University who prepared the drafts of the amendment for the Bar Committee had raised some of the same objections during the committee's deliberations (as did this author to some extent); nevertheless the questioned provisions were retained largely on the vote of the practitioners on the committee. Professor Joseph W. Bishop, Jr., of Yale, has been the principal critic of the underlying ABA-Delaware statute, and his views have engendered the same basic dispute between the concerns expressed by the academicians and those voiced by the corporate bar. See, e.g., Bishop, Types of Liability to Which Corporate Directors and Officers Are Subject and Methods of Protection Against Such Liability, in PLI, PROTECTING THE CORPORATE OFFICER AND DIRECTOR FROM LIABILITY 327, 344-48 (L. Ratner ed. 1970); Bishop, supra note 796, at 1078; Arsht, Bishop, Chalif & Klink, Panel Discussion on Liabilities Which Can Be Covered Under State Statutes and Corporate By-Laws, 27 Bus. Law., Feb. 1972, at 109; cf. Cheek, supra note 796, at 275; Note, Indemnification of Directors and Officers: Public Policy v. Corporate Responsibility, 48 J. Urban L. 957 (1971).
Liability insurance to protect the corporation and its executives from the various liabilities that may be imposed on management under the law is a comparatively recent development. Increasing litigation, especially derivative suits and third party actions seeking enforcement of rights under corporation, securities, and antitrust laws, has led to a rapid rise in its promotion, procurement (and premiums). An extended discussion of such insurance and the problems its use presents is beyond the scope of this survey; however, a good treatment of the subject has recently appeared in the pages of this Journal. In general, a typical policy combines what is in reality two separate insurance contracts, one covering the corporation and providing for reimbursement of amounts it is obligated or permitted to pay by way of indemnification, and the other providing direct coverage for directors and officers for insurable liability in situations where corporate indemnification is not available. Normally the corporation pays ninety percent of the premium to cover the reimbursement part of the policy, while the rest...

Current Texas indemnification provisions, see 20 R. Hamilton, Texas Business Organizations § 731; Knepper, Corporate Indemnification and Liability Insurance for Corporation Officers and Directors, 25 Sw. L.J. 240, 246 (1971). 799. See, e.g., ALI-ABA Course of Study on Insuring Corporate Personnel and Professional Advisors Under Expanding Concepts of Responsibility 9, A-2, A-6 (1970); 20 R. Hamilton, Texas Business Organizations § 733; W. Knepper, Liability of Corporate Officers and Directors §§ 10.03, 10.06 (1969). 800. Although Lloyd's of London has had a directors' and officers' liability policy for over twenty-five years, it was not until the 1960's that the policies currently in use were further developed and intensively sold. See, e.g., ALI-ABA, supra note 799, at 5; W. Knepper, supra note 799, at 173; Note, Liability Insurance For Corporate Executives, 80 Harv. L. Rev. 648 (1967). 801. See, e.g., Bishop, New Cure For An Old Ailment: Insurance Against Directors' and Officers' Liability, 22 Bus. Law. 92, 103 (1966). For example, Professor Cheek, writing in 1969, noted that insurance firms handling indemnity and liability policies in 1968 had reported phenomenal increases in sales. Cheek, supra note 796, at 271. As to the rise in cost of premiums, a policy that would have cost $30,000 in 1965 cost $85,000 three years later. W. Knepper, supra note 799, at 180. See also Gray, Forum—Insurance Against Liabilities of Directors and Officers, 22 Record of N.Y.C.B.A. 342, 357 (1967) for examples of three-year premium costs for various policies. Nevertheless, it appears to be difficult for other than well-established companies with a history of stable management to procure such policies. W. Knepper, supra note 799, at 180; see Panel Discussion, Principal Areas of Insurance Coverage: Markets; Applications; Public Policy Considerations; Other Forms, in PLI, supra note 797, at 213; Gray, supra, at 357. 802. Knepper, supra note 798; cf. Comment, The Liability of Outside Directors as Aiders and Abettors Under Rule 10b-5, 28 Sw. L.J. 391, 411 (1974). 803. See, e.g., W. Knepper, supra note 799, at 177; Cheek, supra note 796, at 271; Panel Discussion, History of Insurance Coverage: Format of Policies, Analysis of Policy Provisions, in PLI, supra note 797, at 121; Note, supra note 800, at 630.
remaining ten percent is paid by the executives covered. Nevertheless, the 1973 amendment makes quite clear that the corporation, by virtue of the power conferred to procure and maintain such insurance, can choose to pay all the premiums, perhaps on the rationalization that the part of the premium covering the personal liability of corporate executives is no more than another form of compensation.

The notion of insuring corporate management against liabilities for non-indemnifiable breaches of fiduciary duties of loyalty and care has always raised the fairly obvious question of its propriety as a matter of public policy, especially if corporate funds are used to pay the premiums. Arguably whatever deterrent the imposition of liability for managerial misconduct or mismanagement is designed to attain is invariably weakened to the extent the wrongdoer knows he will not have to suffer the economic consequences of his actions to a large extent. On the other hand, given the growing complexity of governmental regulation of corporate and business activities and the broadening scope of potential liabilities that even the best-intentioned and prudent director or officer must face these days, the services of highly competent and qualified managers and outside directors may be difficult to acquire or retain unless some assurance can be given that the risks of litigation that can arise from their official conduct or status can be minimized. In weighing these competing factors, the balance has been shifting towards adoption of liberalized indemnification and insurance statutes, as exemplified by the Model Act and Delaware provisions that inspired the partially aborted TBCA amendment on the subject. And it was to overcome possible doubts as to the power of the corporation to procure insurance and maintain it in behalf of directors, officers, and others,

804. See, e.g., Bishop, supra note 796, at 1090; Cheek, supra note 796, at 272.
805. See Arsh & Stapleton, Delaware's New Corporation Law, 23 BUS. LAW. 75, 80 (1967), so stating with respect to the Delaware counterpart to the new TBCA provision.
806. Arsh and Stapleton make this argument with respect to the Delaware statute: "Thus, a corporation may pay premiums on an insurance policy which indemnifies an executive against liability for negligence or other misconduct in the performance of his duty to the corporation. This merely recognizes that to the extent an executive or the corporation may be able to obtain such insurance for the executive's benefit, the corporation may make the premium payments, if it so desires, as part of his compensation." Arsh & Stapleton, supra note 805, at 80. See, e.g., CARY 1005; Cheek, supra note 796, at 273; Note, supra note 800, at 669. Professor Bishop, however, regards this view as "sophistical," arguing that no form of "compensation" through the device of insurance purchased by the corporation should be permitted that allows directors and officers to evade their duties of good faith and care. Bishop, supra note 796, at 1091.
808. The director or officer, assuming he has not been wholly indemnified, will have to bear some of the financial burden of claims covered by the insurance. Generally, policies are issued with a $20,000 deductible and contain co-insurance clauses that require the insured to contribute 5% of any losses above the deductible. Knepper suggests this may be sufficient to sensitize management to its potential liabilities. W. KNEPPER, supra note 799, at 179. See, e.g., Gray, supra note 801, at 357; Hinsey & De Lancey, Directors and Officers Liability Insurance—An Approach To Its Evaluation and a Checklist, 23 BUS. LAW. 869, 870 (1968).
809. See generally 6 Z. CAVITCH, BUSINESS ORGANIZATIONS §§ 129.01-05; W. KNEPPER, supra note 799, §§ 9.01-10.17; Bishop, supra note 796; Panel Discussion, Indemnification of Officers and Directors and Insurance, 27 BUS. LAW., Feb. 1972, at 109.
whether for liabilities asserted against them in their official capacity or their status as such, that the draftsmen of the ABA and Delaware indemnification statutes added the insurance provisions that became part of the TBCA, even though logically they might have been set out separately.\footnote{810}

Despite the broad and seemingly unlimited power to obtain “D & O” insurance the 1973 amendment now confers,\footnote{811} serious doubts remain as to the extent public policy still will allow recovery under such policies for obviously willful violations of criminal or securities laws\footnote{812} or for gross negligence or other intentional misconduct.\footnote{813} This may be so whether the premiums are paid entirely by the corporation or in part by the directors and officers.\footnote{814} Yet these concerns may be more theoretical than real\footnote{815} in light

\footnote{810} Sebring, supra note 795, at 106.

\footnote{811} Professor Bishop contends that taken literally, the Delaware provision (and Model Act-TBCA counterpart) permits a corporation to insure its management against any obligation to account for profits made through self-dealing, the liability for which he regards as the principal deterrent to such misconduct. Bishop, supra note 796, at 1086. This is disputed by Samuel Arsb, one of the draftsmen of the Delaware law, who argues that the power conferred does no more than authorize the corporation to pay premiums on a policy and does not sanction the issuance of a policy insuring against a risk which could or would not be covered in the absence of the statutory authorization. Panel Discussion, supra note 809, at 127. Cf. Note, Indemnification of the Corporate Insider: Directors’ and Officers’ Liability Insurance, 34 Minn. L. Rev. 667, 681 (1970).

\footnote{812} Although the SEC frowns on indemnification of directors, officers, or controlling persons for liabilities arising under the Securities Act of 1933 as violative of public policy, going so far as to condition acceleration on inclusion of an undertaking in the registration statement that the registrant will test the issue in court unless indemnification is waived, note (a) to Rule 460, 17 C.F.R. § 230.460, note (a) (1973), it will not consider insurance against such liabilities a bar to acceleration. Guide 46 for Preparations and Filing of Registration Statements, SEC Securities Act Release No. 4936 (Dec. 11, 1968). Cf. Globus v. Law Research Serv. Inc., 418 F.2d 1276, 1287 (2d Cir. 1969); in general, see, e.g., 1 H. Bloomenthal, supra note 163, §§ 8.27[2], [3]; 3 L. Loss, supra note 799, at 1829; Kroll, Some Reflection on Indemnification Provisions and S.E.C. Liability Insurance in the Light of Bar Chris and Globus, 24 Bus. Law. 681 (1969); Comment, Indemnification of Directors For Section 11 Liability, 48 Texas L. Rev. 661, 677 (1970).

The extent to which insurance can permissibly cover liabilities under other federal securities laws depends to some degree on whether the purpose of imposing liability is to compensate investors harmed by securities law fraud or to punish the wrongdoer. Bishop, Protecting Corporate Executives Against Liability and Expenses Under the Federal Securities Laws, in Emerging Federal Securities Law: Potential Liability 155, 163 (1969). Most commentators agree that coverage against liability for non-willful violations of rule 10b-5 should not be against public policy; on the other hand, since the purpose of section 16(b) liability under the Securities Exchange Act, 15 U.S.C. § 78p(b) (1970), is punitive, insurance coverage should not be permitted; perhaps for this reason, section 16(b) liability is uniformly excluded in virtually all D & O policies. See note 817 infra. In general, see, e.g., ALI-ABA, supra note 799, at 59; Kramer, Insurance Against Liabilities of Directors and Officers: A Forum—Federal Securities Laws, 22 Record of N.Y.C.B.A. 349 (1967); Symposium, supra note 807.

\footnote{813} See, e.g., 20 R. Hamilton, Texas Business Organizations § 733, at 266; Forum, supra note 801, at 368; Knepper, supra note 798, at 249; Note, supra note 800, at 666; cf. Panel Discussion, supra note 809, at 129.

\footnote{814} Professor Bishop believes strongly directors and officers should procure and pay for their own liability insurance, although acknowledging any such requirement could easily be subverted by increases in salary for the tacit purpose of paying premiums. Bishop, supra note 801, at 112; cf. Cary 1005; Note, supra note 800, at 666 (suggesting the corporation might reimburse the executive for his premiums and contending such use of corporate funds would be justifiable).

\footnote{815} Professor Bishop doubts there will be many challenges to a corporation’s decision to obtain insurance protection for its directors and officers even if policies could be found that would compensate them for intentional wrongdoing. He reasons that the amount of premiums that might be recovered would not make the recovery attractive enough for the complaining shareholder’s attorney; that there is little danger insurance regulatory authorities will deem such policies illegal to the extent payment is made for
of the exclusion clauses commonly found in "D & O" policies presently available.\textsuperscript{816} For example, the Directors' and Officers' Liability part of such policies will normally exclude, among other matters, claims based on personal profit or advantages gained to which directors and officers "were not legally entitled" or brought about or contributed to by their dishonesty or to recover short-swing profits under section 16(b) of the Securities and Exchange Act.\textsuperscript{817} Unfortunately, these exclusion clauses leave much to be desired in their draftsmanship\textsuperscript{818} and their latent ambiguities make the degree of protection they afford somewhat questionable.\textsuperscript{819} Even so, the clear-cut authority now granted Texas corporations to obtain liability insurance means honest corporate executives can be given a good deal more protection than the present limited Texas indemnification provision can assure, particularly in regard to third party litigation that attacks actions taken in good faith that were in, or not opposed to, the best interests of the corporation.\textsuperscript{820}

\textit{Liabilities of Managing Shareholders in Close Corporations.} In discussing some of the facets of the new close corporation legislation in this survey,\textsuperscript{821} it was pointed out that the shareholders of a defined close corporation, if they chose, could dispense with management by a board of directors and run the corporation themselves,\textsuperscript{822} or by a unanimous agreement, regulate any phase of the corporation's business and affairs even though they might otherwise impinge on the managerial prerogatives of the board if one were non-indemnifiable.\textsuperscript{823} Such conduct may be actionable simply because of the director's or officer's status as such in the corporation, as in rule 10b-5 cases involving possible misuses of inside information, or suits under section 11 of the Securities Act for falsities or omissions in a registration statement, or possibly antitrust actions. See, e.g., Bishop, supra note 801, at 95; Forum, supra note 801, at 345; Hinsey & De Lancy, supra note 808, at 873.

\textsuperscript{816} See W. Knepper, supra note 799, \S 10.11, for a list of typical exclusions. The Company Reimbursement part of the policy normally excludes excess insurance, pyramiding of coverage, or claims based on personal injury, death, or property damage. The Directors' and Officers' part usually excludes the above, too, plus the matters listed in the text, as well as liability for libel and slander or for remuneration received from the corporation that had been held illegal by a court. Knepper, supra note 798, at 256. See also ALI-ABA, supra note 799, at 92; Forum, supra note 801, at 362.

\textsuperscript{817} 15 U.S.C. \S 78p(b) (1970). For discussion of the section 16(b) liability exclusion see, e.g., ALI-ABA, supra note 799, at 65; Bishop, supra note 801, at 111; Forum, supra note 801, at 364; Hinsey & De Lancy, supra note 808, at 877.

\textsuperscript{818} As might be expected, Professor Bishop has also been quite critical of the draftsmanship of D & O policies, particularly those that first came on the scene, although conceding later policies have been somewhat improved in language. Thus, in 1966 he thought the policies exhibited "such serious defects of coverage and clarity" he would have approached them with considerable reserve even if he had no questions concerning their propriety and validity. Bishop, supra note 801, at 103. Later he observed that the policies currently on the market were "so ambiguous and obscure that it is difficult to say whether and to what extent they cover liability." Bishop, supra note 812, at 165. See also Knepper, supra note 798, at 251.

\textsuperscript{819} See, e.g., ALI-ABA, supra note 799, at 95; Cary 1004; Bishop, supra note 796, at 1088; Knepper, supra note 798, at 255.

\textsuperscript{820} See discussion in text accompanying notes 530-70 supra.

\textsuperscript{821} See discussion in text accompanying notes 530-70 supra.
But such assumption of the directors' rights of management has a price: to the degree the shareholders act in place of the board or agree to limit or control its powers of management, they assume the liabilities imposed by the TBCA or other law on directors. This means, for example, the shareholders may not only become liable for various fiscal improprieties, such as the declaration of illegal dividends or making loans to officers and directors as specified in article 2.41, but also for violation of the general duties of care and loyalty evolved by case law. Presumably a shareholder against whom such liabilities are asserted can also utilize the defenses afforded directors by law. Also, in the case of liabilities that might be imposed because of a shareholders' agreement limiting the board's power, only those shareholders who voted for or assented to the transaction in question will be held accountable.

**Criminal Responsibility.** The newly revised Texas Penal Code, as observed earlier, not only makes corporations and other business enterprises criminally responsible for the first time, but also makes clear that anyone acting in the corporation's name or behalf or failing to discharge a duty imposed on the corporation by law for which he has primary responsibility may be equally culpable. In addition, two of the new crimes that have been defined can affect corporate officers. One deals with commercial bribery and prohibits a fiduciary (defined to include a corporate officer, director, manager, or other participant in the direction of the affairs of a corporation) from receiving any benefits for violating a duty to his beneficiary (defined as the person for whom the fiduciary is acting). The section is designed to deal primarily with kickbacks and of course also applies to the person

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825. Id. art. 2.41(A)(1) (1956).

826. Id. art. 2.41(A)(4).


828. The TBCA provides two defenses for the liabilities asserted under article 2.41: reliance in good faith and in the exercise of ordinary care upon written financial statements of the corporation represented or certified as being correct and similarly, non-negligent good faith reliance upon a written opinion of an attorney for the corporation. Tex. Bus. Corp. Act Ann. arts. 2.41(C), (D) (1956). The latter provides a broader defense in that it pertains to any act arising from the discharge of a duty or power imposed or conferred by the corporation, whereas the former is limited to liabilities for illegal dividends, repurchases of shares or distributions in liquidation. In addition, a director can enter a dissent in the minutes or file one with the secretary of the corporation to avoid the presumption of having assented to a transaction that is later questioned. Id. art. 2.41(B). Also possibly available is the business judgment rule, a common law defense that is sometimes used in mismanagement cases. See generally 20 R. Hamilton, Texas Business Organizations §§ 720-21.


offering or making the bribe.\textsuperscript{833} Another section prohibits misapplication of fiduciary property or property of a financial institution\textsuperscript{834} and includes an officer, manager, employee, or agent carrying on fiduciary functions in behalf of a fiduciary.\textsuperscript{835} Such misapplication, however, must be knowingly or recklessly done and in a manner that involves a substantial risk of loss to the property owner or the person for whose benefit the property is held.\textsuperscript{836} On the other hand, the offense can be committed even though neither actor nor anyone else receives a benefit from the misapplication; if a benefit has been gained, then the crime of theft may be involved.\textsuperscript{837}

B. Case Law Developments

Management Compensation: Bonuses. Among the variety of means for compensating corporate executives and high managerial employees, the cash bonus ranks high as an incentive.\textsuperscript{838} While the corporation undoubtedly has power to pay bonuses to its officers and employees,\textsuperscript{839} their validity may depend upon several factors. If key executives are the recipients of bonuses or profit-sharing plans and comprise a majority of the board of directors, there may be problems of self-dealing.\textsuperscript{840} Even if authorized by a disinterested board, the amounts paid must bear some relationship to the services rendered or else they may constitute a gift or waste of corporate assets.\textsuperscript{841}

\textsuperscript{833} Id., Comment.
\textsuperscript{834} Id. \textsection 32.45.
\textsuperscript{835} Id. \textsection 32.45(a)(1)(C).
\textsuperscript{836} Id. \textsection 32.45(b).
\textsuperscript{837} Id. \textsection 32.45, Comment.
\textsuperscript{838} Bonus and profit-sharing plans, which had been almost unknown prior to 1914, came into widespread use shortly thereafter and by 1929 were common in most large, publicly-held corporations. G. \textsc{Washington} \& \textsc{Rothschild}, supra note 753, at 6. \textit{See generally} 5 \textsc{W. Fletcher}, \textsc{Cyclopedia Corporations} \textsection 2143; \textsc{Henn} \textsection 246; 1 \textsc{F. O'Neal}, \textit{Close Corporations} \textsection 8.11; G. \textsc{Washington} \& \textsc{Rothschild}, supra note 753, at 52; \textsc{Cohen}, \textit{Corporate Bonuses and Stockholders' Rights}, 14 \textsc{Ten. L. Rev.} 87 (1936); \textit{Note, Corporate Bonus and Pension Plans: A "Legitimate Business Purpose" Test}, 48 \textsc{Minn. L. Rev.} 947 (1964).
\textsuperscript{839} \textit{See, e.g.}, \textsc{Tex. Bus. Corp. Act Ann. art. 2.02(A)(17) (Supp. 1974).}
\textsuperscript{840} A.J. \textsc{Anderson Co. v. Kinsolving}, 262 S.W. 150, 152 (Tex. Civ. App.—San Antonio 1924), \textit{error dismissed}; see \textsc{Todd v. Southland Broadcasting Co.}, 231 F.2d 225, 231 (5th Cir.), \textit{cert. denied}, 352 U.S. 845 (1956); \textsc{Greathouse v. Martin}, 100 Tex. 99, 101, 94 S.W. 322, 323 (1906); \textsc{Nelms v. A \& A Liquor Stores, Inc.}, 445 S.W.2d 256, 258 (Tex. Civ. App.—Eastland 1969), \textit{error ref. n.r.e., discussed in Hamilton & Shields, supra note 400, at 99}; \textsc{Shultz v. Resthaven Cemetery, Inc.}, 375 S.W.2d 493, 498 (Tex. Civ. App.—Houston 1964), \textit{error ref. n.r.e. See generally} 5 \textsc{W. Fletcher}, \textsc{Cyclopedia Corporations} \textsection 2129; 20 \textsc{R. Hamilton, Texas Business Organizations} \textsection 716; 1 \textsc{Hornstein} \textsection 440; \textit{Comment, supra note 827}, at 796 (1967). In such cases, shareholder ratification may be the only way to cure the effect of adverse interest. See \textsc{Dowdle v. Texas Am. Oil Corp.}, 503 S.W.2d 647, 651 (Tex. Civ. App.—El Paso 1973) (dictum); \textsc{Western Inn Corp. v. Heyl}, 452 S.W.2d 752, 758 (Tex. Civ. App.—Fort Worth 1970), \textit{error ref. n.r.e., discussed in Hamilton & Shields, supra note 400, at 93}; \textsc{Wiberg v. Gulf Coast Land \& Dev. Co.}, 360 S.W.2d 563, 567 (Tex. Civ. App.—Beaumont 1962), \textit{error ref. n.r.e., noted in} 41 \textsc{Tex. L. Rev.} 726 (1963); \textsc{Pruitt v. Westbrook}, 11 S.W.2d 562, 565 (Tex. Civ. App.—Fort Worth 1928); G. \textsc{Washington} \& \textsc{Rothschild}, \textit{supra} note 753, at 228; \textsc{Lebowitz, Recent Decisions on Fiduciary Duties to Corporations, 2 Bull. of Section on Corp., Banking & Bus. L., May 1963, at 3}; \textsc{Lebowitz, supra} note 827, at 25.
\textsuperscript{841} "If a bonus payment has no relation to the value of services for which it is given, it is in reality a gift in part and the majority of stockholders have no power to give away corporate property against the protest of the minority." \textsc{Rogers v. Hill}, 289 U.S. 582, 591-92 (1933). This famous case involving a bonus plan for American Tobacco Company is discussed in some detail in G. \textsc{Washington} \& \textsc{Rothschild}, \textit{supra}
Similarly, bonuses given for services already rendered when there was no expectation they would be paid may be subject to the same infirmity since they cannot be justified as providing an incentive for better work, more profitable operations, expanded sales, etc.\(^\text{842}\) Finally, any promise or plan to pay bonuses for future services must be properly authorized and sufficiently definite to become a contractual obligation,\(^\text{843}\) as one of the survey cases cogently brings out.

In Douglass v. Panama, Inc.,\(^\text{844}\) former employees sued Panama and its parent corporation to recover certain bonuses they claimed Panama's president,\(^\text{845}\) had promised them for services to be rendered in 1965. The evidence showed that while bonuses had been paid in the past they were negligible in amount except for one year that had been extremely profitable,\(^\text{846}\) and that the company had lost almost $300,000 in 1965. The jury, however, found that certain of the president's statements did not condition payment of the bonuses on Panama's making a substantial profit for 1965.\(^\text{847}\) Nevertheless the evidence was clear that the president told the employees he had no authority to write checks for the bonuses without approval of the parent company's board of directors and that the boards of both Panama and the parent subsequently refused to authorize their payment. The trial court granted defendants a judgment non obstante veredicto.

In affirming, the Houson (14th District) court of civil appeals concluded the president's statements were too indefinite and vague to constitute an enforceable obligation.\(^\text{848}\) It further noted that in Douglass v. Panama, Inc., the former employees had sued Panama and its parent corporation to recover certain bonuses they claimed Panama's president had promised them for services to be rendered in 1965. The evidence showed that while bonuses had been paid in the past they were negligible in amount except for one year that had been extremely profitable, and that the company had lost almost $300,000 in 1965. The jury, however, found that certain of the president's statements did not condition payment of the bonuses on Panama's making a substantial profit for 1965. Nevertheless the evidence was clear that the president told the employees he had no authority to write checks for the bonuses without approval of the parent company's board of directors and that the boards of both Panama and the parent subsequently refused to authorize their payment. The trial court granted defendants a judgment non obstante veredicto.

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able agreement. Moreover, even if they had not been, the probative evidence showed the bonuses were dependent upon Panama making a reasonable profit in 1965. More importantly, the president had no authority to promise or pay bonuses or gratuities as he himself acknowledged in the absence of any delegation of authority or subsequent ratification by the board nor was there any evidence showing such delegation or any pleading or submission of issues indicating he had implied or apparent authority under the circumstances. The Texas Supreme Court subsequently affirmed the Houston court's decision on substantially the same grounds.

Liabilities to Third Parties. Generally speaking, the duties of care and loyalty the law imposes on directors and officers are owed only to the corporation and its shareholders, not its creditors. While such duties may be ultimately enforced by a receiver or trustee in bankruptcy primarily for the benefit of creditors, even then the action is essentially one by a representative in behalf of the corporation. Similarly, those who represent the corporation in its dealings with others are normally not liable in contract if the corporation fails to carry out its undertakings, although if a director or


849. Douglas v. Panama, Inc., 504 S.W.2d 776 (Tex. 1974). The decision will be discussed more fully in the Southwestern Law Journal's 1975 Annual Survey of Texas Law, but the supreme court agreed with the court of civil appeals that the bonuses were conditional on substantial profits being made, but even so were too indefinite and uncertain to be enforceable. It also concurred there was no evidence showing the president had express authority to pay the bonuses; neither was there a basis for apparent authority, especially since the employees had notice of the limits on the president's power. Id. at 779.


851. See 3 W. FLETCHER, CYCLOPEDIA CORPORATIONS § 1180.

officer induces a breach of contract maliciously or for his personal gain he may become liable in tort. By the same token, of course, a member of management who, in the scope of his employment, himself commits a tort or as observed earlier, a crime, may be held responsible therefor along with his corporation. Moreover, despite the general rules of non-liability, there may be a variety of situations where, either by case law or legislation, directors or officers are made directly accountable to creditors or others. For example, liability can be imposed when insolvency has occurred and there is need to protect creditors generally or to assure that franchise or other taxes are paid or to effectuate other statutory policies. In addition, there is the always omnipresent doctrine of disregard of the corporate entity that can be invoked to impose personal liability on a controlling shareholder-director-officer if as the principal actor he has caused harm or economic loss to another in conducting his corporation's affairs. A number of cases decided during the survey period illustrate these principles.

**Insolvency and the Trust Fund Doctrine.** The most important of the decisions is *Fagan v. La Gloria Oil & Gas Co.*, in which Chief Justice Tunks of the Houston (14th District) court of civil appeals, in a well-written opinion, discusses several bases on which directors and officers can become liable for corporate obligations. The action was one in the nature of a creditor's bill brought by La Gloria, an unsatisfied judgment creditor of Cooper Petroleum Company, against the four persons who were Cooper's shareholders, directors, and officers. La Gloria had originally obtained a judgment in 1967 in a suit first brought in 1964 against Cooper and Albert Fagan, Cooper's majority shareholder, as guarantors of obligations of International Marketing, Inc.
(IMI), a company controlled by Fagan. The judgment was appealed, ultimately resulting in the case being remanded, and upon retrial La Gloria obtained a second judgment which became final and non-appealable in 1971. In the interim, Cooper's shareholders apparently did all they could to prevent La Gloria from being able to enforce either of its judgments. For example, Fagan, by virtue of having purchased an assignment of a judgment which the trustee in bankruptcy of IMI had gotten against Cooper and himself, filed judgment liens in the counties where Cooper owned most of its realty, thereby hampering any attempt by La Gloria to levy execution on the properties. All of Cooper's accounts receivable were assigned to Fagan and his son and its bank accounts concealed under another name or manipulated in such a way as to prevent La Gloria from reaching any funds Cooper had on deposit. Cooper's officers awarded themselves large bonuses in 1966 as a means of siphoning off cash even though the corporation operated at a loss that year. Thereafter, most of Cooper's business was diverted into another family owned and controlled corporation and its physical assets acquired either by the latter or by Fagan family members. In the process, all of Cooper's creditors were paid, except, of course, La Gloria and an amount remaining unsatisfied on Fagan's IMI judgment. As a result, when La Gloria tried to enforce its second judgment, no assets of significant value could be found. Thus, the present action ensued, resulting in a substantial judgment for La Gloria, this time against the four Cooper shareholders.

On appeal, La Gloria sought to uphold its judgment on trust fund, denuding
corporate assets, and alter ego theories, while the Cooper shareholders contended that La Gloria's debt was owed only by Cooper for which they had no personal liability under any of the theories. The Houston court of civil appeals considered each issue at some length. It began by noting the general rule, stated above, that ordinarily actions against directors and officers for mismanagement or misconduct can be prosecuted only by the corporation or someone permitted to act in its behalf and cannot be enforced by creditors individually. But it noted a well recognized exception to the rule, the so-called trust fund doctrine, said to be followed in Texas, that regards the officers and directors as trustees for the benefit of creditors of the assets of a corporation that (1) has become insolvent and (2) has ceased doing business. If these two requisites are present, corporate managers then have a fiduciary duty to administer and to ratably distribute the corporation's assets for the creditor's benefit; if they breach that duty, the creditors may sue them directly.

The court next determined whether the two grounds for invocation of the trust fund doctrine had been met. Although Cooper's balance sheet on June 30, 1966, the close of its fiscal year, showed an earned surplus of $102,000, it failed to reflect a judgment IMI's trustee in bankruptcy had obtained against Cooper for $81,000 a month earlier nor did it indicate any contingent liability based on La Gloria's pending suit that later ended with its winning a $160,000 judgment. Moreover, an asset of $192,000, representing an advance to an oil and gas venture payable only out of profits, was deemed overstated. On this basis the court concluded Cooper was insolvent on June 30, 1966. But in so holding, it is evident the court applied a balance sheet or bankruptcy test of insolvency despite the fact the TBCA adopts the equity standard that defines insolvency in terms of the corporation's inability to pay its debts as they become due in the usual course of its business. Nothing in the facts suggests that on the date selected by the court to test insolvency Cooper was not able to pay its debts as they matured, particularly since neither the IMI nor the La Gloria claims had become final, the former having been appealed and the latter still pending in the trial court.

In determining whether the second requirement had been satisfied, the court was confronted with the fact that after June 30, 1966, Cooper continued its business at least on paper on apparently a somewhat substantial scale in that until 1971 it showed gross receipts that ranged from six and a half million dollars in 1967 to one half million in 1971 with profits earned

868. Id. at 629. See 20 R. HAMILTON, TEXAS BUSINESS ORGANIZATIONS § 734, at 268.
870. See HENN 821.
871. TEX. BUS. CORP. ACT ANN. art. 1.02(A)(16) (1956).
in three of the years between those dates. Nevertheless, the Houston court regarded the various actions the Fagan family took to thwart La Gloria from 1966 on as evidencing a scheme to continue the business only for the purpose of paying off their own claims or those of creditors to whom they were secondarily liable and to strip Cooper of its assets and business in such a way as to leave it an empty shell with nothing for La Gloria to levy on. This, in the court's judgment, was not a "good faith" continuation of business that would prevent the trust fund doctrine from being applied. Instead, Cooper's managers carried through a nonstatutory process of dissolution that deprived La Gloria of its equitable shares of the assets. As a consequence they became personally liable not only because their corporation had become insolvent but also because it had ceased doing business in good faith, even if actual operations continued for five years after its supposed insolvency.

The court's strained construction of the facts is explainable primarily by its need to fit them into the two requisites the Texas courts have mechanically adhered to in invoking the trust fund doctrine and that often defeats creditors' rights, as Dean Hildebrand pointed out.\(^\text{872}\) That doctrine, after all, is no more than a device whereby equity can assure that shareholders will contribute to and not improperly withdraw from the assets they have committed themselves to maintain for the benefit of creditors.\(^\text{873}\) If a "trust" must be imposed to thwart an obvious scheme to defraud an individual creditor, as the facts in Fagan divulge, a court sitting in equity should frankly acknowledge it is acting to prevent an obvious injustice, and not simply invoke an artificial formula that may preclude a needed remedy if its terms are not met.

Given the nature of the defendants' actions, the court could have readily rested its decision on the second ground relied on to affirm La Gloria's judgment, namely that by their actions, they had so "denuded" their corporation for their own benefit there remained nothing left to pay La Gloria. Thus to the extent they appropriated Cooper's assets, they became personally liable on its claims. There is respectable authority for this result\(^\text{874}\) and the rule applied more nearly squares with the facts that transpired.

As to the alter ego theory, the court acknowledged it was not really a rule but a way of preventing the corporate entity from being used to work a fraud or injustice, that is sometimes misapplied in cases of this sort.\(^\text{875}\) For example, when Cooper guaranteed IMI's obligations in 1964 and La Gloria's claim was first established, Cooper appeared to be a bona fide corporation acting in its own behalf and in furtherance of its own business. Nor was there any evidence showing that it was then being used

\(^{872}\) See 3 I. Hildebrand, Texas Corporations § 932, at 483.

\(^{873}\) See, e.g., Henn 315; R. Stevens, Handbook of the Law of Private Corporations § 190 (2d ed. 1949).


\(^{875}\) 494 S.W.2d at 632; see 19 R. Hamilton, Texas Business Organizations § 237, at 237-58; Lattin 86; Lebowitz, supra note 131, at 144 n.302.
simply as an agent to carry out the shareholders' personal business or acting as their alter ego. Thus, liability could not be imposed on a disregard basis. However, the court did apply a limited form of the disregard doctrine by ruling that any claim that Fagan had against Cooper's assets based on the IMI judgment he had acquired would have to be subordinated to La Gloria's claim, under the famous "Deep Rock" doctrine, presumably because of Fagan's inequitable conduct.

**Liability as an "Alter Ego."** Two cases were decided, however, that did find an officer individually liable for a corporate obligation on essentially an alter ego rationalization. In one, an action was brought against a cotton merchant, his almost wholly-owned corporation, and others for damages resulting from the purchase of warehouse receipts from the corporation for cotton later found to be nonexistent. Judgment was rendered against the merchant as well as his corporation for breach of both express and implied warranties despite his contention that he should not have been held personally liable. The record showed, however, that as president and 99.6% owner of all the corporation's shares, the defendant exercised complete and independent control of the company which was no more than the conduit for the transaction of his own private business. Under these circumstances, the court ruled, the trial court was warranted in holding him personally liable. Not enough facts are given in the opinion to judge whether holding on this point was sound; however, the result is another cogent reminder that the danger of piercing the corporate veil is perhaps more acute in the incorporated proprietorship than in other corporate businesses despite the assurances that are sometimes given that mere ownership of all

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876. The court noted that when Fagan paid the trustee $100,000 for the assignment of the IMI judgment, he apportioned the payment so that all of his personal judgment of $59,000 was taken care of to get his release, meaning he had paid something less than $41,000 for the judgment against Cooper which by then amounted to more than $138,000. He then recouped more than the amount he had thus paid by levying execution on service stations belonging to Cooper. Under the circumstances, the court held, any claim he asserted against Cooper's assets in excess of what he had paid for the judgment, which he had already recovered, could have been subordinated to La Gloria's claim. 494 S.W.2d at 631.


880. See, e.g., HENN § 147; Cataldo, Limited Liability With One-Man Companies and Subsidiary Corporations, 18 LAW & CONTEMP. PROB. 473 (1953); Fuller, The Incorporated Individual: A Study of the One-Man Company, 51 HARV. L. REV. 1373 (1938); Latty, A Conceptualistic Tangle and the One-or-Two-Man Corporation, 34 N.C.L. REV. 471 (1956).
the shares of stock does not per se defeat limited liability. 881

The other opinion was a Fifth Circuit decision 882 and involved an action by a law firm against the president and holder of twenty percent of the shares of a corporation to recover the reasonable value of services rendered in prosecuting a patent infringement case for the corporation. It appeared that when the attorneys learned the corporation was a shell organized solely to hold the patent and bring the infringement suit, they were assured by the president, who said he made all the corporation’s decisions, they should proceed with the litigation 883 and that he would “take care” of the fee. Having been found personally liable for unpaid fees, the president argued that the services had been rendered to the corporation, not himself, and that he had only promised to guarantee payment by the corporation which promise being oral was barred by the Texas statute of frauds. 884 As to the first point, the court observed that since the only asset the corporation would have was its expected recovery in the infringement suit in which the president would share directly, he could have received no more benefit from the firm’s services than if the corporation had never existed. Secondly, the president’s promise was to protect his personal interest, i.e., his share of the contemplated recovery, 885 and not simply to answer for a debt of his corporation in which his only benefit would be the corporation’s continued prosperity—something that accrues to all shareholders alike. 886 Moreover, it was clear that the president personally promised to pay the fee; hence the statute of frauds would be inapplicable in any case.

Liability for Conversion. If a corporate officer in acting for his corporation commits the tort of conversion, he cannot escape personal liability because he took his action for the corporation’s best interest. 887 The rule is demonstrated in Permian Petroleum Co. v. Barrow 888 in which the president of the corporation was held liable for converting secured property even though

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883. The corporation ultimately lost the patent infringement suit. See V & S Ice Machine Co. v. Eastex Poultry Co., 437 F.2d 422 (5th Cir. 1971). Thereafter the law firm withdrew from the case and sent several bills for attorneys’ fees to the president’s home for approximately fourteen thousand dollars which were not paid. 471 F.2d at 1188.


885. His “leading object” in making the promise was to secure a direct benefit for himself and not for another; hence his promise did not fall within the statute of frauds. See, e.g., Haas Drilling Co. v. First Nat’l Bank, 456 S.W.2d 886, 890 (Tex. 1970); Gulf Liquid Fertilizer Co. v. Titus, 163 Tex. 260, 354 S.W.2d 378, 382 (1962); Walker v. Lorehn, 355 S.W.2d 71 (Tex. Civ. App.—Houston 1962), error ref. n.r.e.


the proceeds were used to pay off corporate debts. The facts showed the
president had entered into an agreement with the plaintiff creditor to assign
it the proceeds of an auction sale of equipment belonging to the corpo-
ration, subject to prior liens, and that at the auction, the president, being dis-
satisfied with the apparent sales price of a truck, bought it for the corpora-
tion and later sold it at a private sale to pay off other debts. The trial
court found for the defendant, ruling there was no basis in the evidence to
warrant a disregard of the corporate entity on the ground the corporation
had become the president's alter ego. The El Paso court of civil appeals
reversed, correctly holding that the case was not one for disregard, but
rather for the imposition of liability on a corporate officer for his own
wrongdoing, in this case for selling off secured property and misapplying
the proceeds.

Statutory Liability. In three cases, a director or officer faced personal lia-
bility because of statutory provisions. In Cannon Ball Truck Stop, Inc.
v. Mobil Oil Corp.889 a service station dealer and his apparently wholly-
owned corporation were held liable for the amount of taxes on diesel fuel
paid by their customers which their supplier (Mobil) had previously paid
for them890 but neglected to collect for four-and-a-half years. The corpo-
ration's liability, however, was limited to the amount of taxes not remitted
after it was incorporated, for though a corporation is sometimes held respon-
sible for the personal debts of its controlling shareholder,891 such liability
normally does not extend to debts incurred prior to incorporation, in the
absence of fraud. The dealer, on the other hand, was held liable not only for
the taxes collected from the public prior to incorporation but also for those
not remitted afterwards on the theory that since all the invoices for the
fuel were made out to him, he was in effect a supplier to his corporation
and in that capacity should have collected the tax from it for transmittal to
the state. Not having done so, he was therefore accountable.

In Bottoms v. Lyons892 a corporate officer who in his individual capacity
indorsed a note to a law firm in partial payment for legal fees owed by his
corporation to the firm was held personally liable as an indorser on the
note, even though he claimed he acted under a unilateral mistake in indors-
ing the note individually and not as an agent for the corporation. Under
the Uniform Commercial Code an indorser is liable to the holder of an in-
strument unless the indorsement specifies otherwise.893 There being no
fraud or misrepresentation or mutual mistake of fact, the parole evidence
would prevent the officer from testifying as to his unilateral intent.

889. 501 S.W.2d 927 (Tex. Civ. App.—Houston [14th Dist.] 1973), error ref. n.r.e.
the supplier is to collect the tax from each non-bonded dealer who in turn collects it
from the consuming public. Id. art. 10.03 (Supp. 1974). The dealer has the primary
responsibility for collecting the tax, as the supplier is merely the agent for the state. If
the supplier pays the tax, he then becomes legally subrogated to the state's cause of ac-
tion to collect the tax. 501 S.W.2d at 929.
891. E.g., American Petroleum Exchange, Inc. v. Lord, 399 S.W.2d 213, 217 (Tex.
Civ. App.—Fort Worth 1966), error ref. n.r.e.
Finally, in Nuclear Corp. of America v. Hale, a federal court action, a materialman (Nuclear) brought an action against three persons who were the sole shareholders, directors, and officers of Mac Steel, Inc., a defunct incorporated subcontractor, for materials Nuclear had furnished Mac Steel on two construction jobs, one in Texas and one in Oklahoma, for which it had not been paid even though Mac Steel had been compensated for its work by the general contractor for each job. Nuclear's primary causes of action were based on statutes of Texas and Oklahoma that make proceeds paid to a subcontractor a trust fund for the benefit of materialmen who furnish construction materials to the subcontractor; in addition, the Texas statute makes any officer, director, or agent of the subcontractor "having control or direction" of the subcontractor the trustee of such funds, and the Oklahoma statute makes the "managing officers" of an incorporated subcontractor personally liable for the proper application of such trust funds. In applying the two statutes, including the finding of an implied civil cause of action in the Texas statute, the court considered the corporate role of each of the three defendants and concluded that the two who had been active in Mac Steel's management would be held accountable even though the funds they collected had been paid out in the ordinary course of business, but that the third whose role was passive and was confined to that of a director who was sometimes consulted about the company's financial condition and on one occasion loaned it money but who made no managerial decisions could not be held liable under either statute. On the other hand, the court declined to impose common law liability against the three for having caused Mac Steel to undertake the two projects when they knew it was in financial trouble in the absence of any showing they had not acted in good faith or with an intent to defraud Nuclear. The court applied the general Texas rule, previously discussed in this section, that when officers act in good faith and with due care they are not personally liable to corporate creditors for the corporation's insolvency absent fraud or some specific provision of the law to the contrary.

899. The court determined that since a materialman's lien is a creature of the law of the state where the real property benefited by the materials furnished is situated, Oklahoma law applied to any agreement for the supply of materials that benefited property there and Texas law applied to property benefited in that state. Professor Baade observes that since both laws were applied uniformly to produce the same result as to liability or non-liability of the defendants, the decision was really a false-conflicts case as that term is understood. Baade, supra note 894, at 222.
900. The court invoked the rule that when a statute is both penal and remedial it should be considered as a penal statute when being used to enforce a penalty and as a remedial statute when it is being employed to enforce a civil remedy. See, e.g., Board of Ins. Comm'n v. Great Southern Life Ins. Co., 150 Tex. 258, 266, 239 S.W.2d 803, 809 (1951).
901. See authorities cited in note 850 supra.