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CORPORATIONS

by

Margaret H. Amsler*

DURING THE past year, Texas appellate courts continued to resolve issues of corporation law which fall within the six categories adopted for the previous *Surveys*.¹ There were in addition a number of cases dealing with relations between corporations and state and local governments, so a new category has been added to include these cases.

Again much corporate litigation during the *Survey* period involved problems peculiar to the close corporation. Perhaps these problems will be relieved soon. The Committee on Corporation Law of the Texas State Bar Section on Corporation, Banking and Business Law is planning in the near future to study the advisability of adopting special statutes to govern the incorporated proprietorship or the incorporated partnership. Any Committee recommendations resulting from the study will be communicated to the members of the Bar.

The Fiduciary Duty of Officers and Directors. In *Petroleum Anchor Equipment, Inc. v. Tyra*² the Texas Supreme Court reversed the Dallas court of civil appeals' holding³ that a corporation had not established its right to a cancellation of two assignments of letters patent. The holder of pending patent rights had transferred them to the plaintiff corporation. The president of the corporation then transferred the rights back to the original holder pursuant to a "resolution" purportedly passed on January 8, 1963, but actually never adopted by the Board of Directors. Shortly thereafter the holder transferred the rights to the defendant, who paid for them on March 4. As grounds for cancellation of the latter two assignments, the corporation asserted that its president had, without authority, made a gratuitous transfer of a corporate asset. The jury found that there was no consideration for the original transfer from the holder to the corporation, and that the corporation's directors were informed of the contents of the resolution after January 8 and failed to act as ordinary prudent persons under the circumstances. On the basis of these findings the court of civil appeals held that the transfer of the patent rights to the corporation was invalid because made by a debtor for the purpose of placing an asset beyond the reach of creditors, and also that the corporation was barred by estoppel and by ratification from attacking the transfer *from* the corporation.

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¹ See Amsler, *Corporations, Annual Survey of Texas Law*, 22 Sw. L.J. 59 (1968); Pelletier, *Corporations, Annual Survey of Texas Law*, 21 Sw. L.J. 134 (1967).

² 419 S.W.2d 829 (Tex. 1967). For further discussion, see McElhaney, *Texas Civil Procedure*, this *Survey*, at footnote 40.

³ *Petroleum Anchor Equip., Inc. v. Tyra*, 410 S.W.2d 238 (Tex. Civ. App. 1967). For discussion of this case, see Amsler, *Corporations, Annual Survey of Texas Law*, 22 Sw. L.J. 59, 69-70 (1968).

In reversing, the supreme court held the transfer *to* the corporation valid because lack of consideration in the executed assignment to the corporation "did not render the transfer of legal title ineffective or void."⁴ The court further concluded that the corporation was not estopped to cancel the transfer *from* the corporation, because "the party asserting an estoppel must establish that he relied on the misleading conduct to his detriment."⁵ Thus, the defendant had to prove that he relied to his detriment either on the resolution per se or on the negligence of the plaintiff after January 8. The supreme court found "neither conclusive evidence nor a jury finding of detrimental reliance"⁶ on either. Ratification of the transfer from the corporation could not be considered, for it was not properly pleaded as an affirmative defense under rule 94.⁷

In another case⁸ a court of civil appeals considered the evidence necessary to support a temporary injunction issued in a suit against a corporate officer and director for making personal profits and acquiring properties in competition with his corporation. The injunction was issued by the trial court in very broad terms: the defendant was restrained from disposing of any of his lands, oil and gas and mineral leasehold estates, stocks, bonds, stock certificates, promissory notes and other monies, assets, and properties. On appeal, the defendant complained that the language of the writ was too broad, applying to all of his assets with no attempt to trace the tainted money into specific assets. Affirming the trial court, the court of civil appeals pointed out that the function of a temporary injunction is to preserve the status quo until the matter in litigation can be finally settled. In the hearing on the injunction, the plaintiff need show only a probable right and a probably injury; he is not required to establish that he will prevail. The court relied on *International Bankers Life Insurance Co. v. Holloway*,⁹ where the Texas Supreme Court held that a defendant charged with a breach of fiduciary duty has the burden of proving the fairness of his transactions with the corporation. In the instant case, not only did the defendant not make this attempt, but he "took advantage of the provisions of the Fifth Amendment to the United States Constitution"¹⁰ in refusing to testify.

The wrongful "appropriation" of corporate assets by former stockholders and directors was the basis of a proceeding brought by a corporation's judgment creditor.¹¹ The appropriation was accomplished by the use of an inside position to have the corporation purchase certain of the defendants' shares on credit, for which the corporation executed its promissory note, secured by a lien on corporate property. When the note was not paid, the former stockholders foreclosed their lien and purchased the

⁴ *Petroleum Anchor Equip., Inc. v. Tyra*, 419 S.W.2d 829, 832 (Tex. 1967).

⁵ *Id.* at 833.

⁶ *Id.* at 834.

⁷ Tex. R. Civ. P. 94.

⁸ *Baucum v. Texam Oil Corp.*, 423 S.W.2d 434 (Tex. Civ. App. 1967), *error ref. n.r.e.*

⁹ 368 S.W.2d 567 (Tex. 1963).

¹⁰ *Baucum v. Texam Oil Corp.*, 423 S.W.2d 434, 440 (Tex. Civ. App. 1967).

¹¹ *Burton Mill & Cabinet Works, Inc. v. Truemper*, 422 S.W.2d 825 (Tex. Civ. App. 1967), *error ref. n.r.e.*

property at the foreclosure sale. The plaintiff, a judgment creditor of the corporation, alleged that the transaction constituted a fraud on corporate creditors and prayed that the assets be charged as a trust, that a receiver be appointed, and that the assets be applied to payment of creditors.

One defendant, a former director, contended that her liability was limited by article 2.41 to the difference between the price paid by the corporation for the shares and the earned surplus which, at the time of purchase, the corporation was permitted to pay under article 2.03C, TBCA.¹² However, this attempt to use the director-liability provision contained in article 2.41 as a limitation on a director's liability failed. The court's holding indicated that the particular liabilities provided in that article are cumulative rather than exclusive of others. The attempt seemingly was doomed from the start, since article 2.41A begins "In addition to any other liabilities imposed by law upon directors of a corporation"¹³

The court did not consider a possible alternative basis for the decision. Section F of article 2.03, TBCA,¹⁴ provides that "*In no case shall a corporation purchase its own shares when there is reasonable ground for believing that the corporation is insolvent, or will be rendered insolvent by such purchase or when, after such purchase, the fair value of its total assets will be less than the total amount of its debts.*"¹⁵ The corporate note to the defendants was in the amount of \$55,000 and one year later, at the foreclosure sale, the total assets were purchased by the defendants for \$5,000. In the absence of evidence explaining this circumstance, the corporation's purchase of its shares seems clearly in violation of section F. Although section F does not expressly give creditors the right to pursue corporate assets in the hands of officers and shareholders, it seemingly embodies the principle upon which corporate creditors, prior to the TBCA, could set aside a transfer of corporate assets as a fraudulent conveyance.¹⁶ As stated by Dean Hildebrand, "The stockholders of a corporation cannot transfer the corporate property to themselves, directly or indirectly, and thereby defeat the rights of creditors of the corporation. The stockholders will be liable to the unpaid creditors of the corporation for the value of the corporate assets wrongfully received."¹⁷

Disregard of the Corporate Entity. In *Bell Oil & Gas Co. v. Allied Chemical Corp.*¹⁸ the court of civil appeals and the supreme court disagreed as to the basis of the liability of one corporation for the debts of an affiliated corporation and a subsidiary corporation. The family tree of the companies involved had its roots in a limited partnership, Lubell & Company. This partnership owned the shares of Bell Oil & Gas Company, which sold petroleum products at wholesale. The partnership also owned the out-

¹² TEX. BUS. CORP. ACT ANN. art. 2.03C (1955).

¹³ *Id.*

¹⁴ *Id.* art. 2.03.

¹⁵ *Id.*

¹⁶ See *id.* art. 2.03, comment.

¹⁷ 3 I. HILDEBRAND, TEXAS CORPORATIONS § 929, at 468 (1942).

¹⁸ 420 S.W.2d 779 (Tex. Civ. App. 1967), *rev'd*, 431 S.W.2d 336 (Tex. 1968).

standing shares of Mid-Tex Development Company, which operated a number of filling stations, for which operations it was given an original capital of \$1,000. Mid-Tex bought its gasoline and oil from Bell until it had run up a debt of \$1,000,000. Understandably, at this point Bell stopped selling on credit to Mid-Tex and sent one of its officers to take over the management of Mid-Tex and to try to salvage something on this debt. Mid-Tex then began buying its gas and oil from Texas Gas Corporation (no kin) with Bell guaranteeing payment for these purchases. Texas Gas was paid for all its sales until yet another corporation, Allied Chemical, acquired Texas Gas and became the seller of petroleum products to Mid-Tex. Bell made no guarantee to Allied Chemical. When Mid-Tex had run up a bill with Allied Chemical in excess of \$60,000, Bell set up a subsidiary corporation, Appollo, which took over the operation of Mid-Tex. Appollo, also capitalized for \$1,000, ran up a bill with Allied Chemical in excess of \$30,000, and Allied Chemical then became thoroughly disenchanted with selling any more products to either Mid-Tex or Appollo. Both Mid-Tex and Appollo were judgment-proof, so Allied Chemical attempted to bypass their corporate entities and to hold Bell liable for their debts.

The trial court found that there was no conspiracy, no joint venture, and no fraud, but concluded that Lubell & Company and Bell "so used their respective stock ownership" of Mid-Tex and Appollo "as to make these companies a mere agent, representative, adjunct, device, stooge, or dummy" through which Bell engaged in the filling station business in Texas.¹⁹ The court of civil appeals agreed that this finding was substantiated by the record, and affirmed.

The supreme court doubted that name-calling was a sufficient basis for holding a company liable for the debts of its "stooge" or "dummy."²⁰ It examined the real basis of such vicarious liability in a contract situation, quoting with approval the following statement by Professor Carol M. Shanks:

The attempt to hold a parent corporation where the claim asserted is of contractual origin presents added difficulties. The very reasonable question must be met and answered why one who contracted with the subsidiary and received the promise which he bargained for but who has been disappointed . . . should then be allowed to look to the parent. As a matter of contract right it is evident that he may not. Additional compelling facts must appear.²¹

As to the nature of such "additional compelling facts," the court reasserted the basic rule:

Courts will not disregard the corporate fiction and hold individual officers, directors or stockholders liable on the obligations of a corporation except where it appears that the individuals are using the corporate entity as a sham to perpetuate a fraud, to avoid personal liability, avoid the effect of a statute, or in a few other exceptional situations.²²

¹⁹ 420 S.W.2d at 781.

²⁰ 431 S.W.2d at 339.

²¹ *Id.* at 339-40.

²² *Id.* at 340.

From its examination of the record the court found no compelling facts which required a holding that Bell was liable for the debts of Mid-Tex or Appollo. It therefore reversed and rendered in favor of Bell. The moral of this litigation seems to be that a sophisticated seller ought to examine its purchaser's credit rating before extending credit.²³

The use of corporate forms to avoid Texas usury laws was established as a sufficient reason for ignoring separate corporate entities.²⁴ Bessemer Forging Company sued two individuals²⁵ to recover double the amount of usurious interest²⁶ paid by it on a loan. Barns and Daniels, the individual defendants, had Chill Juice, Inc., a Texas corporation with nothing but a charter, borrow \$120,000 from Republic National Bank. Chill Juice executed a note in that amount to the bank, individually guaranteed by Barns and Daniels. Chill Juice then lent \$100,000 to Bessemer and paid the \$20,000 finder's fee to Sapphire Homes, Inc., an insolvent Florida corporation entirely owned by Barns and Daniels. Bessemer executed its note payable to Chill Juice for \$120,000 at five and one-half per cent interest. Chill Juice pledged the Bessemer note with the bank as collateral for its loan. Subsequently, Bessemer borrowed \$124,088.34 from a Fort Worth bank, paid off the loan to Republic, and filed suit to recover the statutory penalties.

The court of civil appeals agreed with the trial court that Chill Juice, Inc., and Sapphire Homes, Inc., were simply corporate forms used by Barns and Daniels to cloak an usurious loan. The court held that the \$20,000 paid to Sapphire Homes was "received" by Barns and Daniels and that the \$4,088.34 paid as interest to Republic was also "received" by Barns and Daniels because it was paid on the Chill Juice note which they had guaranteed. Judgment against the individual defendants for double these amounts was affirmed.

In another case²⁷ the attempted "rending the corporate veil" failed. An insolvent corporation had issued the plaintiff, an unpaid employee, a note in the amount of his past due wages. When the note was not paid, the employee sought individual judgment against an officer-director who, although not an incorporator or stockholder, had made substantial loans to the corporation. The trial court gave judgment against the defendant, concluding that the corporation was dominated and controlled by her, and that there was such a unity of interest and ownership between the defendant and the corporation that it was merely an instrument used as her alter ego in order to avoid the legal obligation to the plaintiff.

²³ Arnold v. Phillips, 117 F.2d 497 (5th Cir.), *cert. denied*, 313 U.S. 583 (1940).

²⁴ Sapphire Homes, Inc. v. Gilbert, 426 S.W.2d 278 (Tex. Civ. App. 1968), *error ref. n.r.e.*

²⁵ The third individual defendant was the attorney who prepared the transaction. He was exonerated in the trial court, and the court of civil appeals affirmed.

²⁶ The loan here involved was apparently made before the effective date of TEX. REV. CIV. STAT. ANN. art. 1302-2.09 (Supp. 1968), which was added to the Texas Miscellaneous Corporation Laws Act in 1967. But even this amendment, which permits one and one-half per cent interest per month to be charged to corporations on loans of \$5,000 or more, would not have authorized the rate of interest charged in this case. In fact, the interest rate charged could have subjected the lenders to the additional penalties for usury provided in § (2) of article 1.06 of the Consumer Credit Code. TEX. REV. CIV. STAT. ANN. art. 5069-1.06(2) (Supp. 1968).

²⁷ Minchen v. Trease, 425 S.W.2d 435 (Tex. Civ. App. 1968), *error ref. n.r.e.*

The court of civil appeals reversed. It pointed out that it was not the defendant, but one Callahan, the corporation's president, who established and operated the corporation. Moreover, the plaintiff had been employed by Callahan, had accepted conveyances of corporate land executed by him, and had taken the corporate notes in question from him. Apparently, during all pertinent times the plaintiff knew that the defendant was the real source of the corporate finances but never sought her guaranty of the corporation's obligation. Since the plaintiff "undoubtedly knew the essential facts"²⁸ and chose to deal with the corporate entity, he was precluded from claiming that the defendant was the alter ego of the corporation.

During the *Survey* period an appellate court again determined the personal liability of partners who incorporate without giving statutory notice of incorporation required by article 1302-2.02.²⁹ The court of civil appeals, affirming the trial court, concluded that merely adding "Inc." to the firm name on company checks and on the company truck did not give adequate notice of the incorporation to persons selling goods to the firm. Thus the individual owners of the firm were held liable for goods delivered to the firm. The significant fact in this case, however, is that "the [defendants] started buying feed"³⁰ from the plaintiff *three years after* the partnership was incorporated. In other recent cases³¹ the plaintiff had done business with the partnership prior to its incorporation.

It seems that article 1302-2.02 was not designed to protect creditors in plaintiff's position. Since the language of the statute is that, if the notice requirements are not complied with, "no *change* shall take place in the liability of such firms or the members thereof,"³² it in effect codifies a type of partnership by estoppel. Once partners start doing business in that capacity, persons with whom they deal as partners are entitled to rely on the continuance of the relationship until they receive notice to the contrary. When a partnership is incorporated, this statute prescribes the form of notice to end the original representation of the partnership. Since the defendants apparently never represented to the plaintiff that they were partners, there was no reason to notify them that they had ceased to be partners.

Ultra Vires. The Texas Supreme Court has granted writ of error in a case in which a seller sought to recover from two guarantors of a corporation's debts, the price of commodities he sold to the corporation.³³ One of the guarantors was another corporation which had executed a written guaranty

²⁸ *Id.* at 438.

²⁹ *Gay Harris & Son v. Schlather & Sons*, 423 S.W.2d 467 (Tex. Civ. App. 1968). Note: Former art. 1307, Tex. Rev. Civ. Stat. Ann. was re-enacted in 1961 as art. 2.02, Tex. Misc. Corp. Laws Act, and is now codified as TEX. REV. CIV. STAT. ANN. art. 1302-2.02 (1962).

³⁰ *Gay Harris & Sons, Inc. v. Schlather & Sons*, 423 S.W.2d 467 (Tex. Civ. App. 1968).

³¹ See, e.g., *American Smelting & Ref. Co. v. Ridgway*, 412 S.W.2d 675 (Tex. Civ. App. 1967), *error ref. n.r.e.*; *Anderson v. Smith*, 398 S.W.2d 635 (Tex. Civ. App. 1965); *Hobbs v. Triangle Supply Co.*, 378 S.W.2d 726 (Tex. Civ. App. 1964).

³² TEX. REV. CIV. STAT. ANN. art. 1302-2.02 (1962).

³³ *Cooper Petroleum Co. v. La Gloria Oil & Gas Co.*, 423 S.W.2d 645 (Tex. Civ. App. 1967), *error granted*.

of the purchase price of gasoline supplied by the seller to the purchasing corporation. The shareholders and officers of the purchasing and the guarantor corporations were interrelated. The guarantor corporation argued that the guaranty was illegal and void under articles 1349 and 1302-2.06,³⁴ which establish limitations on creation of corporate indebtedness.³⁵ However, the court of civil appeals held that this defense was a plea of *ultra vires* and was not available to the corporation under article 2.04B, TBCA.³⁶

The other guarantor, an individual, contended that his guaranty was oral and therefore unenforceable by reason of the statute of frauds. The appellate court concluded, in line with a jury finding that it was to the direct financial interest and benefit of the individual guarantor that the plaintiff continue to deliver its products to the purchasing corporation, that the "main purpose" rule prevented the individual guarantor from raising the defense of the statute of frauds. Further, the court was of the opinion that the individual defendant was estopped to raise the defense of the statute, since he knew that his representation would cause the plaintiff to sell gasoline to the corporation.

Corporate Securities. Most of the cases which involved corporate securities were concerned with the applicability of the Texas Securities Act³⁷ rather than the failures or obligations of issuing corporations.

Under section 34 of the Act³⁸ a person seeking to recover for services rendered in the sale or purchase of securities must show (1) that he is a licensed securities dealer and that the securities sold were properly registered, or (2) that the transaction or securities was exempt under section 5 or section 6. In a recent case, a plaintiff who had no broker's license attempted to recover a commission from a real estate investment trust which allegedly "purchased" corporate shares from him.³⁹ The plaintiff, at the request of the defendant, had negotiated an agreement under which the shareholders of a corporation exchanged their corporate shares for shares in the defendant trust. Subsequently, the assets of the corporation were transferred to the trust. The defendant contended that the transaction failed to qualify for any of the exemptions of the Act and that the plaintiff was thus precluded from recovering his commission. On the basis of this defense, the trial court entered a summary judgment for the defendant.

The court of civil appeals affirmed. In addition to rejecting plaintiff's contentions that the Act does not protect *purchasers* of securities for liability for the broker's commission⁴⁰ and that the transaction was exempt

³⁴ TEX. REV. CIV. STAT. ANN. arts. 1302-2.06 (Supp. 1968), 1349 (1962).

³⁵ *Id.* art. 1349 prohibits a corporation from using its resources other than "to accomplish the legitimate business of its creation, or those purposes otherwise permitted by law . . ." One of the purposes not permitted by law is found in *id.* art. 1302-2.06, which prohibits corporations from creating "any indebtedness whatever except for money paid, labor done . . . or property actually received . . ."

³⁶ TEX. BUS. CORP. ACT ANN. art. 2.04B (1955).

³⁷ TEX. REV. CIV. STAT. ANN. art. 581-5H (1964).

³⁸ *Id.* art. 581-34 (1964).

³⁹ *Maddox v. Flato*, 423 S.W.2d 371 (Tex. Civ. App. 1967), *error ref. n.r.e.*

⁴⁰ *Id.* at 373.

as a sale to a trust company,⁴¹ the court resolved the question of whether the transaction was exempt as a merger or consolidation.⁴² The court pointed out that this exemption applies only to an exchange of shares between corporations, and held that the defendant investment trust, despite certain similar characteristics, was not a corporation. Consequently, the "merger" exemption was not applicable.⁴³

The court's refusal to characterize a "real estate investment trust" as a corporation seems to be a triumph of form over substance. Texas prohibits a corporation from having real estate investment as a purpose.⁴⁴ Thus, Texas corporations were unable to take advantage of the 1960 amendments to the Internal Revenue Code which provided a "mutual" company investing in real estate the same income tax benefits as had previously been provided a "mutual" company investing in securities.⁴⁵ To remedy the situation, Texas devised the real estate investment trust. Although such associations are termed "trusts," most of the provisions of the statute authorizing⁴⁶ them were borrowed from the TBCA, and investors are offered limited liability similar to that allowed corporate shareholders. Perhaps these "trusts" should be considered corporations for purpose of the Texas Securities Act.

The civil liabilities section of the Texas Securities Act was determinative in another case.⁴⁷ One brother sought to recover from his older brother the purchase price of securities which the older brother had allegedly sold him. The "securities" were not registered, nor was the older brother a licensed broker. Where there is a "sale" under these circumstances, the Act allows the purchaser to recover the consideration he paid for the securities.⁴⁸ The older brother argued, however, that he had not "sold" anything to his younger brother. The evidence established that: the defendant wrote the plaintiff a lengthy letter explaining the investment program and strongly recommending participation; the plaintiff obtained all his information from the defendant; the defendant had contemplated becoming a dealer in the securities in question and had taken some preliminary steps in that direction; the original letter named no principals whom the plaintiff could contact if he wished to invest; the defendant obtained for the plaintiff further information regarding the investment; the plaintiff sent his check to the defendant, who deposited it and forwarded his own check for the purchase of the securities; and the security was made payable to the defendant and sent to him. The jury found that the defendant had not "sold" the securities in question, but the trial court ignored the jury findings and entered judgment for the plaintiff.

The court of civil appeals affirmed, holding that as a matter of law the older brother "sold" the securities to the younger. The court cited *Brown*

⁴¹ TEX. REV. CIV. STAT. ANN. art. 581-5H (1964).

⁴² *Maddox v. Flato*, 423 S.W.2d 371, 376 (Tex. Civ. App. 1967), *error ref. n.r.e.*

⁴³ *Id.*

⁴⁴ TEX. REV. CIV. STAT. ANN. art. 1302-4.01 (1962).

⁴⁵ INT. REV. CODE of 1954, §§ 856-58.

⁴⁶ TEX. REV. CIV. STAT. ANN. art. 6138A (1962).

⁴⁷ *Smith v. Smith*, 424 S.W.2d 244 (Tex. Civ. App. 1968).

⁴⁸ TEX. REV. CIV. STAT. ANN. art. 581-33 (1964).

*v. Cole*⁴⁹ as controlling on what activity constitutes a "sale" under the Act, and considered the instant facts virtually identical to those in *Brown*. The reader is thus advised that, no matter how strongly he may be convinced of the value of a particular investment, he must exercise caution in recommending to members of his family that they join him in getting rich quickly.

Another case dealt with a situation which must be every broker's nightmare.⁵⁰ The plaintiff broker, by mistake, forwarded certificates for 250 shares of Texas National Petroleum Company to the defendant customer, who had actually ordered 250 shares of Tex N Petroleum Company. Upon discovering the mistake the broker requested the return of the certificates that had been sent and tendered the right certificates. The customer, however, proceeded to sell the shares represented by the wrong certificates. The broker sued for conversion and recovered in the trial court.

In affirming, the court of civil appeals made three holdings. First, the court noted that even if the plaintiff were guilty of "unilateral mistake," lack of "clean hands," or "contributory negligence" these defenses were not available in an action for conversion. Secondly, although conceding the defendant's acquisition of the certificate to be rightful, the court refused to hold that compliance with the Uniform Stock Transfer Law, now repealed,⁵¹ operated to pass title to shares transferred by mistake. Thirdly, the court approved the measure of damages allowed by the trial court. The defendant had sold the mistakenly transferred securities for \$1,656.25. However, the plaintiff subsequently paid \$1,812.50 to acquire the correct shares which the defendant had refused to accept, and the trial court based damages on the higher figure. The appellate court relied on the familiar principle that a conversion of property of fluctuating value accompanied by fraud, willful wrong, or gross negligence permits the aggrieved party to select the highest market value between the date of the conversion and the date of trial as the measure of damages.

Shareholders' Rights. The rights of minority shareholders to examine the corporate books was the hotly contested issue in one case involving three mandamus proceedings.⁵² Minority shareholders sought the original writ of mandamus under article 2.44, TBCA,⁵³ to compel the corporation to allow them access to the corporate books. Apparently the petition, particularly the allegation of a "proper purpose," met the requirements of that article so as to allow the plaintiffs the inspection. However, the corporation contested the claim of proper purpose and affirmatively alleged that the plaintiffs' purposes were improper. After the corporation had qualified procedurally for a jury trial on the purpose issue, the plaintiffs applied

⁴⁹ 155 Tex. 624, 291 S.W.2d 704 (1956).

⁵⁰ *Ligon v. E.F. Hutton & Co.*, 428 S.W.2d 434 (Tex. Civ. App. 1968), *error ref. n.r.e.*

⁵¹ Formerly art. 1302-6.02, Tex. Rev. Civ. Stat. Ann. The language of that article does not seem to be contained in UNIFORM COMMERCIAL CODE § 8-309, now TEX. BUS. & COM. CODE § 8.309 (1967).

⁵² *Uvalde Rock Asphalt Co. v. Loughridge*, 423 S.W.2d 602 (Tex. Civ. App. 1967), 425 S.W.2d 818 (Tex. 1968).

⁵³ TEX. BUS. CORP. ACT ANN. art. 2.44 (1955).

for a discovery order requesting the right to inspect fourteen named items which comprised virtually all of the books and records of the company. Without disposing of the question of proper purpose *vel non*, the trial court granted the discovery order.

The corporation immediately filed a petition for mandamus in the court of civil appeals, asking that court to set aside the discovery order on the ground that by its use the plaintiffs would obtain corporate books and records without a showing of proper purpose. The court declined jurisdiction on the basis that the defendants still had their right to a jury trial on the issue of proper purpose.

Feeling that a jury trial after the plaintiffs had already obtained the inside information would be something of a hollow remedy, the corporation filed an original petition for mandamus with the supreme court. The supreme court held that where "a corporation, in resisting a stockholder's attempt to inspect the books and records, raises by its pleading a fact issue over whether the stockholder has a proper purpose for wanting to see the books,"⁵⁴ the corporation has a right to a jury trial. Since the corporation had raised such an issue and the discovery order deprived it of the right to a jury trial, the corporation was entitled to a writ of mandamus ordering the trial judge to expunge the order of discovery.

A shareholder in another close corporation complained that the corporation had violated a restriction on the transferability of shares.⁵⁵ A unanimously-adopted resolution of the board of directors stipulated that no shareholder would sell his shares without first offering them to the corporation and that, if the corporation refused the offer, the shareholder would be free to sell to anyone. Subsequently, the three shareholders reached a point of serious disagreement and one of them wanted out. He was unwilling, however, to leave the minority shareholder at the mercy of the plaintiff, the third shareholder with whom the other two had been unable to agree. The selling shareholder and the minority shareholder executed a written agreement that they would vote together to have the corporation refuse to take the shares. Through their combined vote the corporation rejected the offer and the shares were sold to an outsider. The plaintiff sought to enjoin the sale, arguing that the resolution constituted a contract binding the shareholders to its terms. The trial court refused to issue the injunction.

The court of civil appeals expressed doubt that the restrictions on the transfer of the shares were valid. It pointed out that, under article 2.22A of the TBCA,⁵⁶ restrictions on transferability must be expressly set forth in the articles of incorporation or the bylaws, and it thought that this statutory requirement should be followed.⁵⁷ However, the TBCA deals only with restrictions imposed *by the corporation*, not with private con-

⁵⁴ Uvalde Rock Asphalt Co. v. Loughridge, 425 S.W.2d 818, 820 (Tex. 1968).

⁵⁵ Irwin v. Prestressed Structures, Inc., 420 S.W.2d 491 (Tex. Civ. App. 1967), *error ref. n.r.e.*

⁵⁶ TEX. BUS. CORP. ACT ANN. art. 2.22A (1955).

⁵⁷ The court did not refer to TEX. BUS. CORP. ACT ANN. art. 2.19F(1) (1955), which recognizes that such restrictions may be contained in an "agreement" among shareholders, provided the agreement is filed with the secretary of state and is incorporated by reference into the articles or bylaws.

tracts between shareholders under which they mutually agree to restrict the transferability of their shares, and it was because of such a contract that the plaintiff urged he should prevail.

Assuming *arguendo* that the resolution constituted a binding private contract, the court nevertheless affirmed because it found that the contract was not breached. The resolution contemplated that the corporation might refuse to purchase but did not specify the shareholder vote or the director vote necessary for the corporation to make an effective rejection of the offer of the selling shareholder. Consequently, the rejection by the usual majority at both the board meeting and the shareholders' meeting was sufficient unless the vote in either case was invalid. At first blush, the voting agreement between the two shareholder-directors appears to have violated the Texas rule prohibiting a contract between directors binding them in advance of a meeting to vote their shares for their personal advantage. The only evidence the court found, however, was that the agreement bound the parties to vote as shareholders, not as directors. Because the agreement did not take undue advantage of the third shareholder, the results of both meetings were upheld.

Another case involved the right of a purchasing shareholder to protect the corporate name against a selling shareholder who, immediately after the sale, incorporated a competing business under a similar corporate name.⁵⁸ The defendant shareholder, Edward Hanover, had established a reputation as a manufacturer of stock trailers. His business was incorporated as the Hanover Manufacturing Company, Inc. As a result of disagreement between the shareholders, the plaintiff bought out the defendant, the sale being evidenced by a contract providing that the plaintiff was acquiring the "good will" of the business, but specifically negating any implication that Edward Hanover was covenanting not to compete. Hanover promptly set up the Ed Hanover Trailers, Inc., just across the road and started competing. The plaintiffs sued to enjoin this competition and to recover damages, alleging that Hanover and two others had conspired to enter into unfair competition with the plaintiff, and had fraudulently appropriated the good will and trade name of Hanover Manufacturing Company, Inc. The jury found the corporate names so similar that the public could be expected to deal mistakenly with one corporation when intending to deal with the other, and found other issues supporting the plaintiff's conspiracy and fraud allegations. On this verdict the trial court gave judgment for the plaintiff.

The court of civil appeals reversed. It held that Edward Hanover had a right to the use of his own name, that he had not contracted away that right, and that any injury resulting to the plaintiff from his exercise of that right was *damnum absque injuria*. The supreme court reversed the court of civil appeals.

Relations with State and Local Governments. A recent case⁵⁹ may signal

⁵⁸ *Ed Hanover Trailers, Inc. v. Hanover Mfg. Co.*, 421 S.W.2d 144 (Tex. Civ. App. 1967), *rev'd*, 434 S.W.2d 109 (Tex. 1968).

⁵⁹ *Manning v. State*, 423 S.W.2d 406 (Tex. Civ. App. 1967), *error ref. n.r.e.*

an increased readiness of the state to challenge questionable business operations. The attorney general instituted quo warranto proceedings seeking injunctive relief, collection of taxes and penalties, ouster, and receivership against a foreign corporation not authorized to do business in Texas, and against individuals who were using the name of the corporation to carry on the unauthorized business.⁶⁰ The corporate defendant, an insurance company, was organized in Nassau, in the Bahamas. It had obtained no certificate of authority from the Insurance Commissioner to sell insurance in Texas and, apparently, had simply printed up a large number of insurance policies and mailed them to one of the individual defendants in Texas for him to sell. The "agent" sold these policies, sent a "commission" of twelve and one-half per cent of the proceeds to the organizer of the corporation, and pocketed the rest of the premiums. No applications were sent to the company for approval, and claims were paid by the "agent" from his personal funds without consultation with the company. Taxes, although collected, were never paid.

The court of civil appeals held the corporation, its president, and the Texas "agent" liable for conducting without a certificate of authority an insurance business using the name of the corporation. The court therefore affirmed the trial court's judgment appointing a permanent receiver to wind up the affairs of the corporation, and its injunction ordering all defendants to cease pursuing the insurance business. Further, the court upheld piercing the corporate veil to hold the individual defendants liable for the statutory penalties⁶¹ imposed for unauthorized conduct of business. Since the corporation held no funds or assets in Texas, the bank account of the Texas "agent," which consisted substantially of premium funds, was placed in receivership. In answer to the "agent's" complaint that some of the funds in the account were his own, the court invited him to file his claim with the receiver.

In another case the state was not so successful.⁶² The Austin court of civil appeals held that the state, suing a foreign corporation and the surety on its \$500 bond for delinquent taxes, was not entitled prima facie to recover the full \$500, but was required, like any other litigant, to plead and prove the amount of the delinquencies and penalties due.

The Regulatory Loan Act of 1963 prohibits the issuance of more than sixty licenses to any one person "directly or indirectly, or through subsidiaries or holding companies."⁶³ Beneficial Finance Company of Midland is the wholly owned subsidiary of Beneficial Finance Company of

⁶⁰ The pertinent provisions of TEX. REV. CIV. STAT. ANN. art. 6253 (1962), the Act under which the proceeding was brought, are:

If any person shall usurp, intrude into or unlawfully hold or execute . . . any . . . franchise, . . . or any association of persons shall act within this state as a corporation without being legally incorporated, or any corporation . . . exercises power not conferred by law . . . the Attorney General . . . either of his own accord or at the instance of any individual relator, may present a petition . . . for leave to file an information in the nature of quo warranto in the name of the State of Texas.

⁶¹ TEX. BUS. CORP. ACT ANN. art. 8.18C (1955).

⁶² State v. Jasco Aluminum Prods. Corp., 421 S.W.2d 409 (Tex. Civ. App. 1967).

⁶³ Tex. Laws 1963, ch. 205, at 550, codified as TEX. REV. CIV. STAT. ANN. art. 6165b (Supp. 1968), repealed, amended, revised and re-enacted in 1967, Tex. Laws 1967, ch. 274, at 659, codified as TEX. REV. CIV. STAT. ANN. art. 5069 (Supp. 1968).

Delaware, which also owns sixty other Texas corporations, each licensed under the Texas Regulatory Loan Act. The Regulatory Loan Commissioner denied the application of the Midland company for a license on the ground that its parent company already had sixty licenses. Appealing the ruling, the company contended that the sixty-license limitation is unconstitutional in that it denies the company equal protection of the law by discriminating against it in favor of banks, savings and loan associations and other competitors. Upholding the commissioner, the court of civil appeals treated the Delaware corporation as the actual applicant.⁶⁴ Since the Delaware corporation had received substantial benefits (the privilege of charging otherwise usurious interest) under the Regulatory Loan Act, the court concluded that the corporation could not attack its constitutionality.

The city of Fort Worth and the Fort Worth Independent School District assessed for taxes 277 buses belonging to Greyhound Lines, Inc., a California corporation.⁶⁵ The taxes were paid under protest and the company sued for a refund. The supreme court held that the buses, because of their continued use in Texas, had acquired a tax situs in this state apart from their constructive domicile in California. As Fort Worth was Greyhound's principal place of business in Texas, the city's governmental units could properly levy a nondiscriminatory tax on the full value of the rolling stock. Article 1175,⁶⁶ authorizing home rule cities to provide for "the mode and method of assessing taxes" was held to be ample authority for the adoption of a fair and reasonable formula to arrive at the full value.

In a suit by the state to collect sales taxes, the corporate defendant contended that it was not obliged to pay sales taxes on that portion of its sales price which consisted of transportation costs.⁶⁷ The court of civil appeals overruled this contention, holding that the sales contract required the seller to deliver to its customers, and thus the freight charges were a part of the sales price. The supreme court has granted writ of error.

Miscellaneous. There were four cases dealing with corporate problems which do not fit into any of the established categories for the *Survey* but which are worthy of note. In one⁶⁸ the sloppy handwriting of a sheriff apparently was the basis of a bill of review sought by a corporation. The sheriff served citation on the president of the corporation on September 12; thus appearance day was October 3. The president mailed the citation to the corporation's lawyer, who was out of his office for several days and did not see the citation until about September 22. The lawyer read the date of service as September 17, and consequently determined that appearance day was October 10. A default judgment against the corporation was taken on October 7. The trial court denied the bill of review and the court of civil appeals affirmed this judgment. The appellate court concluded that the

⁶⁴ *Beneficial Fin. Co. v. Miskell*, 424 S.W.2d 482 (Tex. Civ. App. 1968), *error ref. n.r.e.*

⁶⁵ *Greyhound Lines, Inc. v. Board of Equalization*, 419 S.W.2d 345 (Tex. 1967).

⁶⁶ TEX. REV. CIV. STAT. ANN. art. 1175 (1963).

⁶⁷ *State v. Gifford-Hill & Co.*, 428 S.W.2d 451 (Tex. Civ. App. 1968), *error granted*.

⁶⁸ *Central Airlines, Inc. v. Kahle*, 419 S.W.2d 873 (Tex. Civ. App. 1967), *error ref. n.r.e.*

plaintiff had not by fraud, accident or wrongful act prevented the defendant from presenting its meritorious defense and also that the corporation's president's knowledge that service was had on September 12 was notice to the lawyer-agent.

Another case was brought to restrain the use of a "deceptively similar" corporate name.⁶⁹ The defendants, a San Antonio group, originally planned to use the name "Bull and Bear Club"⁷⁰ as an appropriate designation for a private club for stockbrokers, but were advised by the secretary of state that the name was already in use by a Houston club. Being unwilling to press the Houston group for written consent, the San Antonio incorporators prefixed their club's name with that of the city, and the secretary of state accepted these articles for filing. Suit by the Houston group followed. The trial court found that the names of the two clubs were not deceptively similar because of the difference in their territorial jurisdiction and denied the injunction. The court of civil appeals affirmed, declaring that "[t]he test of whether a corporation is entitled to an injunction against use by another corporation of a similar trade-name is whether the similarity of names, trade-marks, etc., used by the parties are such as to mislead the public."⁷¹ Applying this test, the court concluded that the public was not being deceived.

A recent case⁷² illustrates difficulties which can arise when shareholders in a close corporation agree to apply certain partnership consequences to their transactions. The plaintiff and a fellow shareholder orally agreed that the latter would reimburse the plaintiff forty-nine per cent of all sums which the plaintiff advanced to pay corporate obligations. Also, the defendant apparently expected a promissory note in the amount of contribution due. When the defendant failed to contribute, the plaintiff sued on the oral agreement or, alternatively, on the note. Since the plaintiff's pleading was in the alternative, his evidence related both to the oral agreement and to the note, and issues were submitted to the jury on both counts. On appeal, a jury finding that the note was valid, was not attacked. The defendant complained, however, that the evidence admitted as to the oral agreement for contribution not only violated the statute of frauds prohibition against parol promises to answer for the debt of another, but also that this evidence supplied the jury with the motive or "causa" for the execution of the note. The court was of the opinion that the oral agreement did not violate the statute of frauds. The agreement, said the court, constituted an original, independent obligation to the plaintiff and not a collateral promise to pay the debts of the corporation. In regard to the defendant's second complaint, the court concluded that, absent a motion by the defendant to limit the oral agreement evidence to that issue, the spill-over effect onto the note

⁶⁹ Bull & Bear Club v. San Antonio Bull & Bear Club, 424 S.W.2d 489 (Tex. Civ. App. 1968).

⁷⁰ Article 2104, the "corporate name" article of Tex. Non-Profit Corp. Act (codified as TEX. REV. CIV. STAT. ANN. art. 1396-2.04 (1962)), does not require that the name of a non-profit corporation include a term indicating that it is incorporated.

⁷¹ Bull & Bear Club v. San Antonio Bull & Bear Club, 424 S.W.2d 489, 491 (Tex. Civ. App. 1968).

⁷² Johnson v. Logwood, 430 S.W.2d 679 (Tex. Civ. App. 1968), *error ref. n.r.e.*

issue formed no basis for reversible error. The trial court's judgment for the plaintiff, based on the jury finding as to the validity of the note, was thus affirmed.

In another case, the issue was whether the rights of one partner in a partnership lumber business survived a voluntary dissolution and accounting in 1949 so as to give him an interest in a lumber business incorporated in 1964 by the other partner, his brother.⁷³ The plaintiff alleged that the business was really a partnership and that he was a partner. According to the jury findings, the partnership existing between the two brothers had been dissolved, and a winding-up of the partnership business and final accounting had occurred more than four years before the filing of this suit. Thus, the plaintiff's cause of action was barred by the special four-year statute of limitations governing suits between partners.⁷⁴ The jury further found that no assets of the partnership had been transferred to the corporation and that apparently there was no agreement between the brothers with reference to ownership of the corporation. Since the plaintiff pursued his asserted cause of action with great vigor, one wonders whether the Dead Man's Statute⁷⁵ precluded his introducing evidence of some kind of contract he might have had with his brother, now deceased, prior to the 1964 incorporation.

⁷³ *Heathington v. Heathington Lumber Co.*, 420 S.W.2d 252 (Tex. Civ. App. 1967), *error ref. n.r.e.*

⁷⁴ TEX. REV. CIV. STAT. ANN. art. 5527 (1958). This article reads:

There shall be commenced and prosecuted within four years after the cause of action shall have accrued, and not afterwards, all actions or suits in court of the following description: . . . 3. Actions by one partner against his co-partner for a settlement of the partnership accounts, . . . and the cause of action shall be considered as having accrued on a cessation of dealings in which they were interested together.

⁷⁵ TEX. REV. CIV. STAT. ANN. art. 3716 (1926).