



January 1970

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Robert W. Hamilton

Recommended Citation

Robert W. Hamilton, *Corporations and Partnerships*, 24 Sw L.J. 91 (1970)
<https://scholar.smu.edu/smulr/vol24/iss1/9>

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CORPORATIONS AND PARTNERSHIPS

by

Robert W. Hamilton*

ALTHOUGH several important judicial decisions appeared during the current survey period, the most significant events which occurred in the area of business associations were legislative or administrative.

I. LEGISLATIVE DEVELOPMENTS

Texas Business Corporation Act. Most of the revisions made in the Texas Business Corporation Act during the past year were minor. However, two of these revisions—the short form merger section and the administrative dissolution of corporations—are significant. Other minor changes are collected in the note.¹

The new “short form merger” statute² allows a parent corporation owning at least ninety per cent of the outstanding shares of each class of a subsidiary corporation to merge the subsidiary into the parent without a shareholders’ vote of either corporation. The theoretical basis of the statute is that a vote of the subsidiary’s shareholders is unnecessary because the minority shareholders are, in any event, unable to block the merger,³ and that a vote of the parent’s shareholders is unnecessary because the merger will not materially affect their rights. The latter conclusion is based on the relatively slight change in the parent’s interest in the subsidiary resulting from the merger. Actually, the underlying purpose of the statute is to effectuate a saving of the cost of proxy solicitations and meetings in situations where the results are predetermined. Moreover, this short merger procedure creates no appraisal rights on the part of dissenting shareholders of the parent.

The most difficult theoretical problem with the short merger statute lies in its treatment of the minority shareholders of the subsidiary. In a

* B.A., Swarthmore College; J.D., University of Chicago. Professor of Law, University of Texas at Austin. The assistance of James Welch, a third-year student at the University of Texas School of Law, is gratefully acknowledged.

¹ Tex. Laws 1969, ch. 835, at 2483, made several changes in the Texas Business Corporation Act: (1) Article 2.10A was modified to permit a “Statement of Change of Registered Office of Registered Agent, or Both” which recites that the change was authorized by either the board of directors or an officer authorized by the board of directors. Previously a recitation that the change was authorized by the board of directors was required. (2) Article 2.10D, relating to resignation of registered agents, was modified to require notice to the corporation that the agent was resigning, followed by a triplicate filing of notice with the Secretary of State. The Secretary must mark “filed” on each copy of the notice, and send one copy to the corporation and one to the agent, retaining the third in his files. Heretofore, the provision pertaining to the procedure for resignation was only skeletal. (3) Analogous changes were also made in articles 8.09 and 8.16 relating to foreign corporations authorized to transact business in Texas. Tex. Laws 1969, ch. 834, at 2477, makes similar changes in the Texas Non-Profit Corporation Act, TEX. REV. CIV. STAT. ANN. art. 1396 (1962).

² Tex. Laws 1969, ch. 280, at 844, added a new article 5.16 to the Texas Business Corporation Act. This amendment is based on an optional provision in the Model Business Corporation Act. See 2 MODEL BUS. CORP. ACT ANN. § 68A (1960). Approximately twenty states have enacted short merger statutes. The ownership requirement in these statutes is variously set at 90, 95 or 100 per cent. For a criticism of such statutes, see Comment, *The Short Merger Statute*, 32 U. CHI. L. REV. 596 (1965).

³ TEX. BUS. CORP. ACT ANN. arts. 5.06, 5.07 (Supp. 1969-1970) require approval of a merger by only two-thirds of the outstanding shares of each class of each corporation.

merger between independent corporations, it is unlikely that two-thirds of the shareholders of a corporation would approve a merger that is unfair to them. However, in the merger of a subsidiary into its parent, no such automatic protection exists against terms unfair to the subsidiary's minority shareholders. To the contrary, terms which are unfair to the minority shareholders may be advantageous from the standpoint of the parent. The new article 5.16E⁴ attempts to avoid this problem by providing a special appraisal procedure for the shares of minority shareholders. A resolution of the directors of the parent corporation, setting forth the securities, cash, or other property offered to the shareholders of the subsidiary, must be included in the articles of merger and must be sent to each shareholder of record of the subsidiary within ten days after the effective date of the merger. Each shareholder then has twenty days in which to object to the merger and to state his view with regard to the fair value of his shares. The corporation, in turn, has twenty days to accept the shareholder's valuation or propose a valuation of its own. The shareholder, if agreement is not reached, finally has sixty days to petition a court of competent jurisdiction, in the county in which the principal office of the corporation is located, to establish the value of the shares as provided in article 5.12.⁵ The procedure is the exclusive remedy of dissenting shareholders in the absence of fraud.⁶

Practical limitations on the value of the appraisal procedure as protection for minority shareholders include: (1) the expense of the proceeding itself, (2) the possible inconvenience of a proceeding in the county in which the corporation's principal office is located, and (3) the additional federal income taxes that may be due if a cash payment is received as contrasted with receipt of securities of the parent corporation, which may qualify as a tax-free exchange.

The other significant revision in the Texas Business Corporation Act during the survey period authorizes involuntary dissolution by administrative action. The franchise⁷ and business corporation statutes⁸ dealing with delinquent corporations were revised to simplify the procedure by which the charters of such corporations are forfeited. Formerly, article 12.14 of the general taxation statutes⁹ provided that failure to file reports or pay taxes would result in administrative action forfeiting "the right to do business" in the state. The courts were closed to such corporations and partnership liability existed for directors and officers who continued the corporate business. If the deficiencies were not corrected within 120 days,

⁴ *Id.* art. 5.16E.

⁵ *Id.* art. 5.12 (1956). After the petition is filed, appraisers are to be appointed to determine the value of the shares.

⁶ If the procedure were not exclusive, the shareholder might have the right to have a jury determine the value of his shares. *Farnsworth v. Massey*, 365 S.W.2d 1 (Tex. 1963).

⁷ The franchise tax statutes were amended by Tex. Laws 1969, ch. 801, at 2366.

⁸ The Texas Business Corporation Act was amended by Tex. Laws 1969, ch. 835, at 2483. The amendments cover the revocation of either a charter of a domestic corporation or a certificate of authority to transact business in Texas of a foreign corporation. *Id.* ch. 834, at 2477, made analogous changes in the Texas Non-Profit Corporations Act, TEX. REV. CIV. STAT. ANN. art. 1396 (1962).

⁹ TEX. REV. CIV. STAT. ANN. art. 12.14 (Supp. 1969).

article 12.15 directed the Attorney General, on notification by the Secretary of State, to bring suit to cause a forfeiture of the charter of the delinquent corporation. The new amendments authorize the Secretary of State to revoke the charter of a corporation upon receipt of a certificate of delinquency from the franchise tax division of the Comptroller of Public Accounts. In this manner, a court proceeding is avoided. In addition, the amendments add, as a ground for involuntary administrative dissolution, the failure to maintain a registered agent. The amendments also provide a grace period of twelve months in which the corporation may correct the ground on which dissolution was ordered or demonstrate that no ground for involuntary dissolution existed.

Corporate Criminal Liability. I have previously analyzed at length the unique Texas approach toward imposing criminal liability on corporations.¹⁰ The 61st Legislature took the first small step toward bringing Texas law into conformity with the law in other jurisdictions in this area.

Texas is apparently the only state which generally refuses to permit a corporation to be criminally responsible for the wrongful acts of its agents. The Texas position is founded on two distinct rationales: (1) The word "person" in the accusatory portions of the Texas Penal Code does not include corporations,¹¹ and (2) there does not exist any procedure by which corporations may be held criminally responsible since the Texas Code of Criminal Procedure invariably assumes that the defendant is an individual.¹²

Senate Bills 5 and 6, which were enacted as additions to the Texas Penal Code, made corporations amenable to criminal prosecution only for two new misdemeanors. These offenses are (1) emitting air contaminants which cause air pollution unless the emission is in conformity with a variance granted by the Texas Air Control Board, and (2) discharging waste into water which causes water pollution unless the waste is discharged in compliance with a permit issued by an appropriate Texas agency.¹³ To overcome the procedural difficulties involved in prosecuting corporations under the Code of Criminal Procedure, the legislation creates a separate code of criminal procedure for these two offenses. This Code may serve as a model for future legislation extending corporate liability to other types of crimes.¹⁴ Proponents of this legislation hope that the new offenses created

¹⁰ See generally Hamilton, *Corporate Criminal Liability in Texas*, 47 TEXAS L. REV. 60 (1968).

¹¹ This construction is based upon an inference drawn from TEX. PEN. CODE ANN. art. 22 (1952): "Whenever any property or interest is intended to be protected by this Code, and the term 'person' or any other general term is used to designate the party whose property it is intended to protect, the protection given shall extend to the property of the State, and of all public or private corporations." See *Judge Lynch Int'l Book Co. v. State*, 84 Tex. Crim. 459, 208 S.W. 526 (1919).

¹² For example, TEX. CODE CRIM. PROC. ANN. arts. 16.01, 16.08, 33.03, 33.06, 42.14 (1966) require that the defendant be "present" at various times during the trial and sentencing. See *Overt v. State*, 97 Tex. Crim. 202, 260 S.W. 856 (1924); *Thompson v. Stauffer Chem. Co.*, 348 S.W.2d 274 (Tex. Civ. App.—Waco 1961), *error ref. n.r.e.*

¹³ The appropriate agency may be the Texas Water Quality Board, the Texas Water Development Board, or the Texas Railroad Commission. Tex. Laws 1969, ch. 154, at 484.

¹⁴ The Texas Attorney General prior to enactment, issued an opinion that this legislation was constitutional. Tex. Att'y Gen. Op. No. M-348 (1969). This writer agrees with the Attorney General's conclusion insofar as it relates to corporations. However, the Attorney General also con-

by this legislation will be a swift and effective tool which can be administered by local district attorneys to combat air and water pollution.¹⁵ It also may appropriately be used to combat leaf burning and other sporadic or occasional acts of pollution.

Professional Corporation Acts. During the regular session, the Texas Legislature passed both a professional corporation¹⁶ and a professional association act.¹⁷ These two pieces of legislation, apparently drawn largely from similar legislation enacted in other states, are not integrated with each other and contain indications of hurried legislative consideration.¹⁸

Before considering the details of these statutes, a brief description of the background may be helpful. Professional corporations and associations are attractive because of federal income tax considerations. Persons engaging in the business of rendering personal services may receive more favorable tax treatment if the business is conducted in corporate form rather than in partnership form. Partners are not deemed "employees" of the partnership and hence are ineligible for substantial employee tax benefits.¹⁹ Earnings may be accumulated at the lower tax rates applicable to corporations and capital gains rates may be applicable upon the ultimate disposition of the stock. Although most personal service businesses may incorporate under the appropriate business corporation act, certain professions such as attorneys, doctors and dentists have been prohibited by law from conducting business in corporate form. Such professionals first attempted to obtain corporate tax treatment through the formation of associations which

cluded that these bills were unconstitutional to the extent that they attempted to impose criminal liability on partnerships, trusts, and associations. This portion of the opinion inexplicably does not refer either to the Uniform Partnership Act (enacted by Texas in 1961) or to the decisions in other jurisdictions permitting partnerships to be criminally prosecuted. See, e.g., *United States v. A & P Trucking Co.*, 358 U.S. 121 (1958).

¹⁵ See generally Comment, *Air Pollution Control in Texas*, 47 TEXAS L. REV. 1086, 1113, n.186 (1969).

¹⁶ Tex. Laws 1969, ch. 779, at 2304 [hereinafter referred to as the TPCA].

¹⁷ *Id.* ch. 840, at 2513 [hereinafter referred to as the TPAA].

¹⁸ The two bills followed similar paths through the legislature. The Senate passed the TPCA on April 22 and the TPAA on May 8. The House passed both bills on May 28, 1969, with a record vote on the TPAA and a non-record vote on the TPCA. The TPCA was approved by the Governor on June 14, 1969 (effective January 1, 1970), and the TPAA was approved on June 18, 1969 (effective immediately).

¹⁹ See Hall, Gissel & Blackshear, *Professional Incorporation in Texas—A Current Look*, 48 TEXAS L. REV. 84 (1969); Hall & Gissel, *Corporate Tax Treatment for Professions in Texas*, 32 TEX. B.J. 588 (1969). The principal tax benefits of conducting a personal service business in the corporate form are as follows: (1) The corporation may deduct, but the employee need not include in his income, premiums for (a) up to \$50,000 of group life insurance on the employee, INT. REV. CODE of 1954, § 79; (b) \$2,000 of group life insurance on the employee's spouse and dependents, Treas. Reg. § 1.61-(2)(d)(ii)(b) (1957), as amended, T.D. 6888, 1966-2 CUM. BULL. 491; (c) disability benefits under group life insurance contracts, Treas. Reg. § 1.79-31(f)(3) (1966); (d) medical expense and hospitalization insurance, INT. REV. CODE of 1954, § 106. (2) The corporation may create qualified pension and profit-sharing plans without regard to the limitations applicable to "Keogh" or "H.R. 10" plans, INT. REV. CODE of 1954, § 401(a). However, under the new tax bill these limitations are applied if the corporation makes a subchapter S election. Wall Street Journal, Dec. 22, 1969, at 8, col. 5. The qualified pension or profit-sharing plan may also provide for capital gains treatment of lump sum settlements, INT. REV. CODE of 1954, § 402(a)(2), and distributions on the death of the employee free of the estate tax, *id.* § 2039(c). Neither of these benefits is currently available under Keogh plans. (3) The corporation may pay a \$5,000 death benefit which is deductible by the corporation and not subject to estate tax by the recipient, INT. REV. CODE of 1954, § 101(b)(2). (4) The employer may create health and accident plans which may make disability income payments of up to \$100 a week. These payments are deductible by the employer and excludable from the income of the employee, INT. REV. CODE of 1954, § 105(b).

resembled corporations in all respects except that articles of incorporation were not filed. This form of organization was accorded corporate tax treatment in the well-known case of *United States v. Kintner*²⁰ and the less well-known Texas decision of *Gault v. United States*.²¹

In response to these decisions, the Internal Revenue Service amended its regulations to exclude virtually all associations subject to the Uniform Partnership Act or Uniform Limited Partnership Act from corporate status.²² When Texas enacted its version of the Uniform Partnership Act in 1961, it included, as section 6(3),²³ a non-uniform provision designed to preserve the right of associations to obtain corporate tax treatment by electing not to be treated as a partnership subject to the Uniform Partnership Act.

In other states, the professional corporation or professional association became the preferred method for avoiding the impact of the Treasury regulations. These regulations relied on state law to determine whether an association possessed specified corporate characteristics.²⁴ The states were quick to bend their laws to provide the new business forms with the necessary corporate characteristics. In addition, in 1962 Congress attempted to narrow the gap between incorporated and unincorporated personal service businesses by permitting unincorporated businesses to establish "Keogh" or "HR 10" plans. However, the substantial limitations on deductions under those plans greatly reduced their desirability.²⁵ The growth of professional corporation or association statutes therefore continued unabated.²⁶ The response of the Internal Revenue Service was predictable. Faced with what it considered to be a substantial loophole, the Service adopted revised regulations purporting to deny corporate tax status to such organizations.²⁷ New litigation followed, resulting in holdings by the courts of appeals of the Fifth,²⁸ Sixth²⁹ and Tenth³⁰ Circuits that the rules were invalid. Unexpectedly, in August 1969, the Internal Revenue Service announced that it did not plan to continue the court battle against professional corporations or associations.³¹ In October, the Service announced that it was requesting legislation to close this loophole;³² however,

²⁰ 216 F.2d 418 (9th Cir. 1954).

²¹ 175 F. Supp. 360 (N.D. Tex. 1959).

²² These are the famous "Kintner regulations," though a more apt phrase would be the "anti-Kintner regulations." Treas. Reg. § 301.7701-2 (1960).

²³ TEX. REV. CIV. STAT. ANN. art. 6132b, § 6(3) (1962). The development of this section is described in Bromberg, *Texas Uniform Partnership Act—The Enacted Version*, 15 Sw. L.J. 386 (1961).

²⁴ Treas. Reg. § 301.7701-1(c) (1960).

²⁵ The principal limitation is that a Keogh plan deduction may not exceed \$2,500 in any one year. Other advantages of incorporation, described in note 19 *supra*, are unavailable in a Keogh plan.

²⁶ As of August 21, 1969, only three states and the District of Columbia did not have such statutes. P-H 1969 FEDERAL TAXES ¶ 41,608.

²⁷ Treas. Reg. § 301.7701-2(h) (1960), added by T.D. 6797, 1965-1 CUM. BULL. 553. The new regulation deleted reference to reliance on state law and instead stated that professional relationships are "inherently different from the relationships characteristic of an ordinary business corporation" and defines most such relationships as being not corporate in character.

²⁸ *Kurzner v. United States*, 413 F.2d 97 (5th Cir. 1969).

²⁹ *O'Neill v. United States*, 410 F.2d 888 (6th Cir. 1969).

³⁰ *United States v. Empey*, 406 F.2d 157 (10th Cir. 1969).

³¹ Treasury Information Release 1019 (1969).

³² Wall Street Journal, Oct. 27, 1969, at 28, col. 2.

this legislation was not forthcoming.³³ As this Article is written, the tax fight continues, and practitioners should be very cautious in making recommendations concerning professional corporations or associations.³⁴

During the survey period, Texas adopted both a professional corporation act (the TPCA) and a professional association act (the TPAA). Since other states generally have enacted one or the other but not both, the first question that should be raised is the relationship between the two statutes. Apparently, the only reason Texas enacted both statutes was that Texas doctors did not like the idea of forming professional corporations. Section 3(a) of the TPCA excludes "physicians, surgeons and other doctors of medicine" from the operation of the TPCA since there are established precedents allowing them to associate for the practice of medicine in joint stock companies. Section 3 of the TPAA, on the other hand, defines "professional services" simply as services for which a license is required "and which service by law cannot be performed by a corporation." Presumably, "corporation" in the latter context includes professional corporations. If this is so, all professionals must use the TPCA except doctors, who, if they wish to form a professional corporation, must use the TPAA. Also, either group may presumably form either a joint stock company³⁵ or a "common law partnership" under section 6(3) of the Texas Uniform Partnership Act³⁶ without complying with the requirements of either the TPCA or the TPAA.

A temporary need to correlate these two Acts also arose because the TPCA became effective on January 1, 1970, while the TPAA became effective on June 18, 1969. If the provisions referred to in the preceding paragraph are read literally, any non-medical professional group could have used the TPAA in the period June 18-December 31, since until January 1, 1970, there was no statute under which the association could incorporate. The Secretary of State in fact accepted filings from any professional group under the TPAA until January 1, 1970; at the time this is written, there has been no resolution of the question of whether non-medical professional associations formed in the interim period must now reincorporate under the TPCA.

While there are many minor differences between a professional corporation organized under TPCA and a professional association organized under the TPAA, the broad outlines of the two business forms are very similar. Each has the following essential attributes:

³³ *Id.* Dec. 22, 1969, at 8, col. 5. The new bill merely limits the deductibility of contributions by professional corporations and associations electing subchapter S treatment to the deductions permitted in Keogh plans.

³⁴ Caution is indicated for several reasons in addition to the continued battle over tax treatment for professional corporations and associations. There may be adverse tax consequences when incorporating an existing business which includes a large amount of uncollected receivables. The new corporation may be subject to additional state taxes, including the franchise tax. Control problems may arise in the formation of a corporation. These and other problems are fully discussed in Hall, Gissel & Blackshear, *Professional Incorporation in Texas—A Current Look*, 48 TEXAS L. REV. 84 (1969). In addition, as discussed below, the substantive law applicable to professional corporations and associations is not always as clear as might be desired. See also Jerome J. Roubik, 53 T.C. No. 36 (1969).

³⁵ TEX. REV. CIV. STAT. ANN. arts. 6133-38 (1962).

³⁶ *Id.* art. 6132(b), § 6(3). See text accompanying note 23 *supra*.

(a) Each is formed by filing articles of association or incorporation with the Secretary of State.³⁷

(b) Each may be organized only to perform one type of professional service.³⁸

(c) Each may be formed by a single practitioner.³⁹

(d) Each may issue shares or "units of ownership" which are issuable or transferable only to persons licensed to perform the same type of professional service as that for which the corporation or association is formed.⁴⁰

(e) Each contemplates that a person rendering professional services on behalf of a professional corporation or association will be personally liable for his negligence. The professional corporation or association will also be liable for the negligence of such person.⁴¹

(f) Each may continue, unaffected by changes in membership or shareholders (at least until the death of the last member)⁴² unless dissolved by a two-thirds vote of the members.⁴³

(g) Each has the customary entity characteristics of a corporation, including property ownership, amenability to suit, and the like.⁴⁴

It is difficult to evaluate possible problems created by the numerous variations in language and approach taken by these two statutes. Section 24 of the TPAA states that "except as otherwise provided in this Act, and except as inconsistent with this Act, the statutory and common law of partnerships shall apply to associations formed under this Act."⁴⁵ In contrast, the TPCA states that "the Texas Business Corporation Act shall be applicable to professional corporations, except to the extent that the provisions of the Texas Business Corporation Act conflict with the provisions of this Act."⁴⁶ Presumably these references to entirely different bodies of law for supplementary legal principles will cause variations in results which may range over a wide spectrum.⁴⁷ As a practical matter,

³⁷ TPAA § 12; TPCA § 4.

³⁸ TPAA § 2(b); TPCA §§ 4, 6.

³⁹ TPAA § 2; TPCA § 4. However, the board of directors of a professional corporation must consist of at least two directors, both of whom are duly licensed. TPCA § 9. No similar provision appears in the TPAA.

⁴⁰ TPAA § 10; TPCA § 12. Serious problems are created by the death of a shareholder which are not really answered by the statutes. See, e.g., TPCA § 14. However, in most cases shareholders' buy-out agreements will provide a practical answer to such problems.

⁴¹ TPAA § 7; TPCA § 16. The precise scope of this liability is not entirely clear. If professional services are rendered by a partnership, each partner is jointly and severally liable for the negligence of any partner or employee. The TPCA and TPAA apparently narrow the scope of this liability by limiting it to the person performing the service and the professional association or corporation. Other shareholders or owners are not personally liable in the absence of their negligence.

⁴² TPAA § 8(B)(2) (until the death of the last member); TPCA § 7(a) (perpetual succession). Articles of association of a professional association may be rejected for filing if they provide for "perpetual succession."

⁴³ TPAA § 18(4); TPCA § 18.

⁴⁴ E.g., TPAA § 5; TPCA § 7.

⁴⁵ TPAA § 24.

⁴⁶ TPCA § 5.

⁴⁷ For example, an individual creditor of a member of a professional association would presumably levy on the association interest of the member by the device of a charging order, on analogy with a partnership. However, if a professional corporation were involved, attachment of the shares would presumably be the appropriate remedy, subject to the perplexing requirement of TPCA § 14 that a non-licensed person succeeding to a shareholder's interest "shall terminate all financial interest in such professional corporation forthwith."

however, shareholder or membership contractual arrangements may fill many of the gaps in legal principles that otherwise would be filled by reference to corporation or partnership statutes.

Throughout these two statutes there are many minor examples of sloppy draftsmanship and failure to conform language. Examples include:

(1) Section 11 of the TPAA states: "The manner in which lawyers practice law *under this Act* is subject to the powers of the Supreme Court to regulate the practice of law."⁴⁸ The only thing which prevents this language from being completely superfluous is that the failure to conform the effective dates of the two statutes allowed attorneys to form professional associations under the TPAA from June 18, 1969 until January 1, 1970.

(2) "Architects" are a group referred to in the TPCA as being unable to incorporate under the general business corporation acts, yet the legislature, during the same session, specifically recognized that architects may do business in the corporate form,⁴⁹ and the Secretary of State has ruled that this permits organization under the Texas Business Corporation Act.

(3) The TPAA contains its own schedule of filing fees.⁵⁰ (Presumably the fees applicable to professional corporations are the same as fees applicable to general business corporations). However, when filing fees were generally raised as a revenue creating device, fees applicable to professional associations were apparently overlooked and not increased.

(4) Professional associations must file an annual statement with the Secretary of State, certifying that all members are licensed professionals.⁵¹ There is no similar requirement applicable to professional corporations, although the need would appear to be the same.

Miscellaneous. The passage of an additional franchise tax on all corporations,⁵² and a new allocation formula for multi-state corporations promises to increase substantially the state's return from this tax.⁵³ Changes in the franchise tax collection procedure were also made.⁵⁴ A new schedule of filing fees for documents filed with the Secretary of State's office was also established.⁵⁵ Of particular interest is the increase of the fee for filing an application of a foreign corporation to transact business in Texas from

⁴⁸ TPAA § 11 (emphasis added).

⁴⁹ Tex. Laws 1969, ch. 802, at 2377, 2380-81.

⁵⁰ TPAA § 22.

⁵¹ TPAA § 21.

⁵² Tex. Laws 1969, ch. 1, art. 3, at 5, 32.

⁵³ *Id.*, ch. 1, art. 7, at 5, 39.

⁵⁴ Tex. Laws 1969, ch. 801, at 2366. These changes include: (1) vesting collection procedures in the Comptroller of Public Accounts rather than the Secretary of State; (2) changing the date of reporting and payment from May 1 to June 15; (3) permitting a foreign corporation to withdraw from transacting business in Texas rather than surrender its Certificate of Authority; (4) requiring foreign corporations to post \$500 in cash rather than posting a bond to cover franchise tax liabilities; (5) changing the indexing procedure for recording franchise tax liens in the county clerk's offices; (6) permitting administrative forfeitures of certificates for nonpayment of taxes; and (7) permitting the reinstatement of judicially forfeited certificates.

⁵⁵ Tex. Laws 1969, ch. 884, at 2701. This legislation doubled most of the fees previously applicable.

\$50⁵⁶ to \$500. The fee for filing articles of incorporation of a domestic corporation was only increased from \$50⁵⁷ to \$100.

The statutes relating to the formation and operation of credit unions were completely revised and brought up to date.⁵⁸ A new state agency, the Credit Union Commission, was created to perform the regulatory functions previously performed by the Banking Commissioner.⁵⁹ Actual regulation is performed by the Credit Union Commissioner, an employee of the Commission who is to be elected by the Commission "by and with the advice and consent of the Senate."⁶⁰

As previously noted, architects were accorded the privilege of conducting business in corporate form, even though personal liability continues to exist.⁶¹ The Secretary of State has construed these amendments to mean that architects are subject to the Texas Business Corporation Act rather than the Texas Professional Corporation Act. Local recording agents engaged in the sale of fire and casualty insurance were also accorded the privilege of incorporating, subject to licensing by the State Board of Insurance.⁶² Incorporation of such businesses is also pursuant to the Texas Business Corporation Act.

The Business and Commerce Code was amended to permit a guarantee of the signature of a fiduciary on an assignment of securities to be executed by an officer of an unincorporated bank or an agent of a firm that is a member of the New York Stock Exchange as well as by an officer of a national or incorporated state bank.⁶³ In addition, the Texas Probate Code was amended to specifically permit personal representatives to register securities owned by the estate in the name of a nominee.⁶⁴

II. ADMINISTRATIVE DEVELOPMENTS

The most significant administrative developments during the year under review concerned interpretations of the "Texas Blue Sky Law" by the State Securities Board. In March 1969, the Board revised its interpretation of the key statutory phrase, "fair, just and equitable"⁶⁵ to eliminate the famous four-fifths test.⁶⁶ This test limited the "spread" permitted between

⁵⁶ TEX. BUS. CORP. ACT ANN. art. 10.01A(4) (Supp. 1968).

⁵⁷ *Id.* art. 10.01A(1).

⁵⁸ Tex. Laws 1969, ch. 186, at 540.

⁵⁹ *Id.* ch. 186, § 38, at 557.

⁶⁰ *Id.* ch. 186, § 47, at 558-60.

⁶¹ *Id.* ch. 802, § 10, at 2377, 2381.

⁶² *Id.* ch. 225, at 668. Such corporations must meet specified financial requirements including a showing of the ability to pay any sum up to \$25,000 on claims for negligence.

⁶³ *Id.* ch. 691, at 2018. Section 33.09 was also amended to make it clear that Texas legislation relating to fiduciary security transfers applies to national banking associations. *Id.* ch. 692, at 2019.

⁶⁴ *Id.* ch. 719, at 2016.

⁶⁵ TEX. REV. CIV. STAT. ANN. art. 581-7C(2) (1964): "The Commissioner . . . may enter an order denying registration . . . if he finds . . . that any consideration paid, or to be paid, for such securities by promoters is not fair, just and equitable where such consideration for such securities is less than the proposed offering price to the public . . ." See also *id.* art. 581-10A.

⁶⁶ State Securities Board, Administrative Interpretation of Section 7C(2) and Section 10A of the Securities Act of Texas (Mar. 26, 1969, amendment). This interpretative statement may be obtained from the State Securities Board; it is reprinted in CCH BLUE SKY LAW REP. ¶ 46,631 (1969). The 4/5ths rule is often referred to as the 5/4ths rule—the public offering price may not exceed 5/4ths of the price to the promoters. Obviously, the two statements are mathematical equivalents.

the public offering price of a security and the price paid by the promoters. The price to the promoters was deemed to be fair, just and equitable if it was as much as four-fifths of the public offering price. As a practical matter, however, the test was not applied where there was an established market price or a history of prior earnings.⁶⁷

The four-fifths test has been criticized on the ground that it results in the setting of prices for securities offerings far below those prevailing in a competitive market.⁶⁸ The elimination of this test was one of the principal objectives of the draftsmen of the proposed Texas Uniform Securities Act which was introduced but not enacted during the recent legislative session. Section 306E of the proposed Act would have precluded an objection by the Commissioner to the market price of a security if the securities were to be distributed pursuant to a firm commitment underwriting and registered under the Federal Securities Act of 1933.⁶⁹ Section 306F further would have excluded from consideration any differential between the public price and the price paid by the promoters where (a) the security was outstanding for a year and "the issuer has been a going concern actually engaged in business" during the year, or (b) the promoters agreed to escrow the security for a year after the offering commenced.

The revised administrative interpretation eliminates all reference to a mechanical formula. It states explicitly that a price determined with reference to established market prices for identical or equivalent securities is ordinarily "fair, just and equitable." It also states explicitly that where the issuer has a reliable record of earnings, a proposed price which "reflects a price earnings ratio . . . reasonably related to the price earnings ratio of securities of similar issues in the same industry which have established market prices" is also ordinarily "fair, just and equitable."⁷⁰

Where the issuer has no established market price and no earnings record, the revised interpretation states that, "primary consideration will be given to the proposed offering price established by the underwriters if there is a firm commitment by the underwriters and the proposed underwriters have the financial ability to perform their commitment . . ."⁷¹ However, if the Commissioner has doubts about the fairness of the pro-

⁶⁷ If the shares had an established market price, the price of the new shares was compared to the market price. If the corporation had an earnings history, the price of the new shares was compared to a reasonable price under current market conditions in light of the earnings history. Even where these patterns were absent it was sometimes possible to persuade the Commissioner that the statutory standard was met even though the 4/5ths rule was not. Hence, despite the apparent objectivity of the 4/5ths rule, a considerable area of administrative discretion nevertheless existed.

⁶⁸ Bromberg, *The Proposed Texas Uniform Securities Act*, 31 TEX. B.J. 1030 (1968), states that this is the "typical" consequence of the 4/5ths rule. The author continues:

Far from consistently protecting Texas investors, the result often is that offerings are not made here at all, thus denying buying opportunities to local investors, commissions to Texas broker-dealers, and financing sources to local businesses. When securities are sold here below their worth in the market, the holdings of prior investors are diluted and the issuing company may get less money than it needs. Moreover, artificially low prices encourage 'free riding' (purchases by insiders and speculators who reap a quick profit on resale when the laws of supply and demand are allowed to determine price in the after-market).

Id. at 1030.

⁶⁹ 15 U.S.C. § 77a (1964).

⁷⁰ CCH BLUE SKY REP. ¶ 46,631 (1969).

⁷¹ *Id.*

posed price, the principal underwriter may be requested to justify his decision to market the securities at the proposed price.⁷² Of course, in the last analysis, the Commissioner must make the final decision as to whether the price is "fair, just and equitable." Finally, if a substantial disparity exists between the price paid by the promoters and the public offering price, the Commissioner may require the promoters to escrow their securities "for a reasonable period of time."⁷³

The State Securities Board has also released an interpretation of section 5(a), which deals with exemptions for shares issued in connection with consolidations, mergers, and similar transactions. The interpretation makes the exemption available to securities issued by a parent company in exchange for shares of another corporation where such corporation is to be merged into an eighty per cent subsidiary of the parent corporation.⁷⁴ While such a transaction does not literally fall within the language of section 5(a), it seems clearly to fall within its intent.

The year also saw significant changes in personnel. At the Securities Board, William M. King resigned as State Securities Commissioner after twelve years in that post. Truman G. Holladay, Deputy Securities Commissioner, was appointed Securities Commissioner to succeed Mr. King, and Roy M. Mouer was appointed Deputy Commissioner. James H. Milam was appointed to the Securities Board replacing Randall Jackson. At the Secretary of State's office, Martin Dies, Jr. became Secretary of State in January 1969.

Both the Secretary of State's office and the State Securities Board handled a large number of matters. During the 1968-1969 fiscal year, the Secretary of State's office accepted for filing about 13,100 articles of incorporation for profit corporations and about 1,760 articles of incorporation for nonprofit corporations; Texas currently ranks fourth in the states in the total number of corporations formed. Only New York, California and Florida record a greater number of incorporations. The State Securities Board processed applications for more than \$1.6 billion of securities. This figure should be contrasted with the \$1.15 billion processed in fiscal 1968 and \$136 million processed in fiscal 1958. Applications processed in the month of August alone exceeded the total of all applications processed in fiscal 1958.

III. JUDICIAL DEVELOPMENTS

The current year did not produce any truly fundamental decisions dealing with the subject under review;⁷⁵ however, there are a few cases

⁷² Factors to be considered include potential earnings, ability and experience of management, the contributions of promoters to the business, and the voting and preferential rights of the proposed issue of securities.

⁷³ There appears to be no specific statutory authority for requiring this form of escrow, though the Commissioner may inherently have the power to impose such a condition; if the escrow is in fact created, it is clear that he has authority to determine that the price is fair, just and equitable. Cf. TEX. REV. CIV. STAT. ANN. art. 581-9 (1964) authorizing the Commissioner to require the issuer to escrow the securities or the proceeds thereof until it is clear that the public's interest is protected.

⁷⁴ State Securities Board, Administrative Interpretation of Section 5(a) (adopted Jan. 16, 1969).

⁷⁵ It should be noted, however, that the year saw several significant federal decisions under the

worthy of consideration which will be classified and discussed in a manner similar to that used in previous *Survey* articles on this subject.

A. Partnerships

Texas enacted its version of the Uniform Partnership Act (hereinafter referred to as TUPA) in 1961.⁷⁶ Apparently the existence of this statute is unknown to many Texas attorneys and Texas appellate judges. Case after case involving partnerships has been decided on the basis of pre-Uniform Act precedents apparently in ignorance of the fact that a Texas statute bears directly on the issue.⁷⁷ Since the Texas Uniform Partnership Act restates many principles of common law partnership, the result reached in many cases is consistent with the result that should be reached if the Act were applied. However, the Texas version of the common law of partnership was less than satisfactory in many respects,⁷⁸ and it is unfortunate that undesirable principles which have been specifically superseded by the Texas Legislature should nevertheless continue to govern decisions. Obviously, the blame for this state of affairs must be shared by the Texas bar as well as the Texas appellate judges.

Three cases during the survey period raised the question of whether, on the facts of the particular case, a partnership relationship was created. None of the cases cited or relied on the simple and rather helpful rules set forth in sections 6 and 7 of TUPA. In *Jenkins v. Brodnax White Truck Co.*⁷⁹ the Tyler court of civil appeals concluded that a lease of a truck under which the gross profits of a trucking operation were shared on a 70-30 basis did not create a partnership arrangement. The court sought to apply the vague common law tests of whether the arrangement created "a community of interest," "common enterprise" or "joint account" and "joint ownership in the profits as such," but ultimately relied primarily on the notion that no inference of partnership should be drawn from a sharing of gross (as contrasted with net) profits.⁸⁰ In *Arnold v. Caprielian*⁸¹ the court of civil appeals held that an agreement to form a partnership in 1949 remained executory and was abandoned where one person never paid in his agreed share of capital, and accepted a refund of the capital he did pay in. The other party then commenced business as a sole proprietorship, and the claim that the partnership existed was not

various federal securities acts dealing with such diverse matters as proxy regulation, tender offers, short swing trading, and the prohibition against insider trading set forth in rule 10b-5. These decisions are considered to be beyond the scope of this Article. Of particular interest to Texas practitioners is *Kuehnert v. Texstar Corp.*, 412 F.2d 700 (5th Cir. 1969), which arose in Texas.

⁷⁶ TEX. REV. CIV. STAT. ANN. art. 6132b (1962); see Bromberg, *Texas Uniform Partnership Act—The Enacted Version*, 15 Sw. L.J. 386 (1961).

⁷⁷ The effective date of the Texas Uniform Partnership Act was January 1, 1962. TEX. REV. CIV. STAT. ANN. art. 6132b, § 45 (1962). In many of the cases described below, the court does not indicate when the transactions occurred. However, it is unlikely that many appeals handed down in 1969 involve pre-1962 transactions.

⁷⁸ See Sher & Bromberg, *Texas Partnership Law in the 20th Century—Why Texas Should Adopt the Uniform Partnership Act*, 12 Sw. L.J. 263 (1958).

⁷⁹ 437 S.W.2d 922 (Tex. Civ. App.—Tyler 1969).

⁸⁰ This distinction appears in TUPA §§ 7(4)(b), 7(3), TEX. REV. CIV. STAT. ANN. art. 6132b, §§ 7(4)(b), 7(3) (1962).

⁸¹ 437 S.W.2d 620 (Tex. Civ. App.—Tyler 1969), *error ref. n.r.e.*

made until several years later. In *Adcock v. Couser*⁸² the Waco court of civil appeals treated a transaction as a loan rather than as the formation of a partnership.

Perhaps the most significant partnership case decided during the survey period is *Burns v. Gonzalez*,⁸³ involving the scope of the agency each partner possesses to bind the partnership and the other partners. The partnership was engaged in selling broadcast time on a Mexican radio station located in Ciudad Acuña. It contracted to sell air time to the plaintiff over a long term, but the station was unable to fulfill the commitment because it was not operating for a period of time. One partner executed the \$40,000 note which was in question either in settlement of the plaintiff's claim or to obtain additional time before the plaintiff brought suit for breach of contract. Judge Cadena recognized that the authority of a partner was governed by section 9(1) of TUPA:

Every partner is an agent of the partnership for the purpose of its business, and the act of every partner, including the execution in the partnership name of any instrument, *for apparently carrying on in the usual way the business of the partnership* of which he is a member binds the partnership, unless the partner so acting has in fact no authority to act for the partnership in the particular matter, and the person with whom he is dealing has knowledge of the fact that he has no such authority.⁸⁴

Relying on the italicized language, Judge Cadena stated that the scope of the agency should be determined from "the way in which other firms engaged in the same business in the locality usually transact business or the way in which the particular partnership usually transacts its business."⁸⁵ Further, the burden was on the party seeking to impose liability on the partnership to establish the facts showing that agency exists. Finally, the court adverted to the distinction established in pre-TUPA cases between "trading" and "nontrading" partnerships,⁸⁶ and concluded that the tests for determining whether a partnership is to be classed as trading or nontrading "is exactly the same test for imposition of liability embodied in section 9(1). This explains the fact that the U.P.A. makes no mention of the distinction between trading and nontrading firms."⁸⁷ On the facts, Judge Cadena concluded that the plaintiff had not shown that the partner was acting within the scope of his authority when he executed the note.

The basic point in this opinion is sound: the scope of a partner's authority should be determined from an analysis of the way business is regularly transacted by the partnership in question or by firms engaged in the same business in the locality. It is unfortunate, however, that Judge Ca-

⁸² 442 S.W.2d 490 (Tex. Civ. App.—Waco 1969).

⁸³ 439 S.W.2d 128 (Tex. Civ. App.—San Antonio 1969), *error ref. n.r.e.*

⁸⁴ TEX. REV. CIV. STAT. ANN. art. 6132b, § 9(1) (1962) (emphasis added).

⁸⁵ 439 S.W.2d at 131.

⁸⁶ See, e.g., *Randall v. Meredith*, 76 Tex. 669, 13 S.W. 576 (1890). Judge Cadena did not refer to Professor Bromberg's "Source & Comments" note to section 9(1): This section "supersedes the prior artificial and irrational distinction between 'trading' partnerships (which have implied power to borrow regardless whether the loan is obtained in the usual course of business) and 'nontrading partnerships' (which have no such implied power)." Bromberg, *Source and Comments to Texas Uniform Partnership Act*, TEX. REV. CIV. STAT. ANN. art. 6132(b), § 9(1), at 244 (1962).

⁸⁷ 439 S.W.2d at 133.

dena felt it necessary to find the common law distinction between trading and nontrading partnerships in section 9. It is true that a partner in a partnership engaged in a retail sales business (a "trading" partnership) may have power to borrow money while a partner in a partnership engaged in the selling of radio time (a "nontrading" partnership) may not. The difference in result, however, is explained by the difference in the nature of the two businesses, not because one may be classed as a "trading" partnership and the other as a "nontrading" partnership. Under the Texas Uniform Partnership Act, the nature of the business is the test and it is both unnecessary and confusing to classify a business as "trading" or "nontrading."

In *Morgan v. Arnold*⁸⁸ the Dallas court of civil appeals upheld a judgment for over \$12,500 in compensatory damages and \$25,000 in punitive damages for fraud practiced by one partner on another partner in connection with the dissolution of a partnership. One partner was active in the business, the other was inactive. After a personal disagreement, the parties agreed that the active partner would purchase at book value the interest of the inactive partner. The active partner submitted financial statements prepared by a partnership employee which showed a one-half interest in the partnership to be worth about \$38,800, and the sale was completed at this price. Subsequently at the trial all expert witnesses agreed this figure was too low though the correct book value was debatable.

Undoubtedly, willful misrepresentation in the circumstances of this case constituted fraud. The court relied on the strong statement in *Johnson v. Peckham*⁸⁹ that a fiduciary duty exists between partners, and when persons enter into a partnership each consents, as a matter of law, to have his conduct measured by the standards of finer loyalties exacted by the courts of equity. The court, however, did not refer to section 20⁹⁰ of the Texas Uniform Partnership Act, which requires a partner to give "true" information to other partners on demand. The award of substantial punitive damages in this case highlights the fiduciary duties a partner assumes when he enters into a partnership.

Article 2293 of the Texas statutes provides that a receiver may be appointed "in an action . . . between partners or others jointly owning or interested in any property or fund, on the application of the plaintiff or any party whose right to or interest in the property or fund . . . is probable, and where it is shown that the property or fund is in danger of being lost, removed or materially injured."⁹¹ This rarely used provision was invoked in one recent case⁹² where a partnership had substantial assets, but irregular withdrawals by several partners and borrowings by the partnership to cover them threatened the orderly conduct of the partnership's

⁸⁸ 441 S.W.2d 897 (Tex. Civ. App.—Dallas 1969).

⁸⁹ 132 Tex. 148, 152, 120 S.W.2d 786, 788 (1938).

⁹⁰ TEX. REV. CIV. STAT. ANN. art. 6132b, § 20 (1962).

⁹¹ *Id.* art. 2293(1) (1964).

⁹² *M. Guerra & Son v. Manges*, 442 S.W.2d 441 (Tex. Civ. App.—Waco 1969). The assets of the partnership included 72,000 acres of land, 2,485 cattle, virtually half of the stock of a bank in Rio Grande City, 150 town lots, and other property.

business. In most situations, the right to an accounting⁹³ is an adequate remedy for a partner; however, where assets are being withdrawn informally and irregularly, a receiver may be necessary to preserve adequately the assets of the partnership pending winding up and termination of the partnership.

B. Corporations

Articles dealing with corporations in previous *Annual Surveys* have established a six-fold functional classification of cases. Although cases did not arise in each of the categories during the survey period, the general format has been followed in the analysis below.

Shares. In *Rutbart v. First State Bank*⁹⁴ shares were issued to an employee by a corporation. To raise the necessary cash, the employee executed a promissory note to the bank which in turn issued its cashiers' check payable to the corporation. The shares were assigned to the bank as collateral. When the note fell due, the employee refused to pay, alleging fraud by the corporation and violation of both article 12, section 6 of the Texas Constitution⁹⁵ and article 2.16 of the Texas Business Corporation Act (hereinafter referred to as the TBCA).⁹⁶ The court of civil appeals quite properly rejected this argument on the ground that the statute and constitutional provision were designed to prevent the corporation from issuing shares without receiving the required consideration, and here the corporation received full payment for its shares when it received the proceeds of the loan.⁹⁷ Assuming (as claimed) that the transaction was fraudulent, the proper solution is suit by the defrauded employees against the corporation and its agents who committed the fraud.

Employees are commonly promised shares in a corporation as part of their remuneration. Article 2.16 provides that shares may be issued only for "work done" and that a promise of future services is not appropriate consideration. In *Irwin v. Prestressed Structures, Inc.*⁹⁸ it was recognized that article 2.16 does not render unenforceable all promises of shares to employees, but merely requires that the shares not be issued until the end of the employment period.⁹⁹

The last decision involving article 2.16 reflects an unfortunate mis-

⁹³ See TEX. REV. CIV. STAT. ANN. art. 6132b, § 22 (1962).

⁹⁴ 431 S.W.2d 366 (Tex. Civ. App.—Amarillo 1968), *error ref.*

⁹⁵ TEX. CONST. art. 12, § 6 states: "No corporation shall issue stock or bonds except for money paid, labor done or property actually received, and all fictitious increase of stock or indebtedness shall be void."

⁹⁶ TEX. BUS. CORP. ACT ANN. art. 2.16A (1956) states that the consideration received may be "money paid," and that shares may not be issued "until the full amount of the consideration . . . has been paid." *Id.* art. 2.16B adds that promissory notes do not "constitute payment or part payment for shares of a corporation."

⁹⁷ The decision is also consistent with one pre-TBCA decision. *Weichsel v. Jones*, 109 S.W.2d 332 (Tex. Civ. App.—Dallas 1937).

⁹⁸ 442 S.W.2d 406 (Tex. Civ. App.—Amarillo 1969).

⁹⁹ The court distinguished *United Steel Indus. Inc. v. Manhart*, 405 S.W.2d 231 (Tex. Civ. App.—Waco 1966), *error ref. n.r.e.*, where shares were issued partially for past services and partially for future services. The *Manhart* court refused to allocate and invalidated the entire issue. Under this decision it may be necessary to wait until the very end of the employment period before issuing shares for "services."

understanding of the statute's purpose. In *Jackson v. Gish*¹⁰⁰ it was alleged that certain directors had issued shares to themselves without consideration. However, after issuance of the shares in question, a resolution was adopted at a shareholders' meeting (by a vote of 84,445 to 12,039) reciting that the defendants had worked for the corporation for four years without adequate compensation, that the corporation did not have sufficient cash to pay the defendants a reasonable salary, that the defendants had waived any claim for cash payment for work previously done, and that the issuance of shares to defendants was therefore validated, ratified and confirmed. A jury apparently found that the directors had agreed to issue shares to themselves without adequate consideration but answered negatively the question of whether the defendants acted "with malice." The court of civil appeals reversed, and rendered in favor of the directors, holding that under article 2.16C the judgment of the directors was conclusive in the absence of fraud as to the value of consideration received for shares,¹⁰¹ and that the jury had found that no fraud existed.¹⁰²

The basic difficulty with this reasoning is that the court considered only article 2.16 and completely ignored the general principle that a director is subject to fiduciary duties whenever he deals individually with the corporation. This principle is particularly apt where a director causes a corporation to issue shares to himself in consideration of services previously performed by the director, since the director may be tempted to issue an unreasonable number of shares. In Texas and elsewhere, a transaction between director and corporation is voidable if unfair,¹⁰³ even though it has been ratified by a majority vote of the shareholders.¹⁰⁴ Thus, the court should have decided the fairness of the transaction rather than relying solely on the absence of fraud.

One important case involving the scope of the private offering exemption of the Texas Securities Act¹⁰⁵ was decided by the Texas Court of Criminal Appeals during the survey period. In *Dean v. State*¹⁰⁶ the defendant was fined \$2,000 for selling securities without a license. The security involved was an "override" contract in Vitro Seat Company whereby for an investment of \$1,000 the purchaser would receive two cents upon each

¹⁰⁰ 440 S.W.2d 121 (Tex. Civ. App.—Waco 1969).

¹⁰¹ TEX. BUS. CORP. ACT ANN. art. 2.16C (1956): "In the absence of fraud in the transaction, the judgment of the board of directors . . . as to the value of the consideration received for shares shall be conclusive."

¹⁰² The court treated the jury finding that the defendants had not acted "with malice" as indicating an "absence of fraud."

It should be noted that the shares apparently were issued irregularly—the consideration for the shares was not "expressed in dollars" as required by TEX. BUS. CORP. ACT ANN. art. 2.15A (1956). Presumably, however, failure to express the consideration in dollars would not automatically invalidate the issuance of shares if some consideration was received and there was no fraud.

¹⁰³ *Henger v. Sale*, 365 S.W.2d 335 (Tex. 1963); *Popperman v. Rest Haven Cemetery, Inc.*, 162 Tex. 255, 345 S.W.2d 715 (1961).

¹⁰⁴ *Wiberg v. Gulf Coast Land & Dev. Co.*, 360 S.W.2d 563 (Tex. Civ. App.—Beaumont 1962), *error ref. n.r.e.* See also Note, 41 TEXAS L. REV. 726 (1963).

¹⁰⁵ TEX. REV. CIV. STAT. ANN. art. 581-51(a) (1964): "[T]he provisions of this Act shall not apply . . . [I] Provided such sale is made without any public solicitation or advertisements, [to] (a) the sale of any security by the issuer thereof so long as the total number of security holders of the issuer thereof does not exceed thirty-five (35) persons after taking such sale into account . . ."

¹⁰⁶ Tex. Ct. Crim. App. No. 41,204 (May 15, 1968).

sale of a Vitro Seat unit. The total number of contract holders was less than thirty-five and no advertising was employed; the private offering exemption was therefore available, absent "public solicitation" in the sale of the override contracts. In the original opinion Judge Onion, in effect, read into the phrase "public solicitation," the tests applicable to the exemption in the Federal Securities Act as set forth in *SEC v. Ralston Purina Co.*¹⁰⁷ These tests limit the private offering exemption to offers to persons who do not need the protection of registration either because they possess or have access to necessary information, or have such close relationships with the issuer as to make fraud unlikely. On rehearing, however, the court substituted a new opinion¹⁰⁸ which did not specify a precise test for determining what is a "public solicitation." After describing the prior Texas cases dealing with the meaning of this phrase,¹⁰⁹ the court stated that the following facts created a jury issue as to whether there was a "public solicitation:" (a) Dean did not seek out the investor but merely participated in completing the sale; (b) the investor had decided before the meeting with Dean to purchase the override contract; (c) Dean's presence at the meeting was not the procuring cause of the sale; and (d) "all [other] facts and circumstances in evidence."¹¹⁰

An option contract to purchase shares of stock is governed by the same principles as an option contract to purchase other kinds of property. If the holder of the option desires to exercise it, he must comply with the conditions of the contract. Two cases during the survey period involved attempts by holders to exercise options to purchase shares. One such attempted exercise was held to be effective, the other not. In *Hundabl v. Armstrong*¹¹¹ the optionee had until April 15, 1967, to exercise the option. At about 4:30 p.m. on April 15, 1967 (a Saturday), he drove to the home of the optionor, stated that he was there to exercise the option, handed the optionor a personal (uncertified) check for the purchase price, and then stated that he thereby exercised the option. The optionor refused to accept the check. On Monday morning, the optionee obtained \$33,748.65 in cash and tendered payment to the optionor, which was refused as being too late. The court of civil appeals held that the option had been effectively exercised by notifying the optionor of its exercise on April 15. Since the option did not require payment on April 15, the optionee had a reasonable time thereafter to complete the transaction. In *Ferguson v. von Seggern*,¹¹² on the other hand, the option agreement contained detailed provisions for determining the option price, including the selection of professional real

¹⁰⁷ 346 U.S. 119 (1953).

¹⁰⁸ *Dean v. State*, 433 S.W.2d 173 (Tex. Crim. App. 1968).

¹⁰⁹ *Birchfield v. State*, 401 S.W.2d 825 (Tex. Crim. App. 1966); *Tumblewood Bowling Corp. v. Maise*, 388 S.W.2d 479 (Tex. Civ. App.—Beaumont 1965), *error ref. n.r.e.* See generally Bromberg, *Texas Exemptions for Small Offerings of Corporate Securities—The Prohibition on Advertisements*, 20 Sw. L.J. 239 (1966).

¹¹⁰ *Dean v. State*, 433 S.W.2d 179 (Tex. Crim. App. 1968). While these justifications may seem unpersuasive, there is also a problem in importing the subjective tests of *Ralston Purina* into a statute which contains specific numerical requirements—apparently the legislature intended the test to be largely numerical. See Bromberg, *Texas Exemptions for Small Offerings of Corporate Securities*, 18 Sw. L.J. 537, 539 (1964).

¹¹¹ 436 S.W.2d 388 (Tex. Civ. App.—Eastland 1968), *error ref. n.r.e.*

¹¹² 434 S.W.2d 380 (Tex. Civ. App.—Dallas 1968), *error ref. n.r.e.*

estate appraisers. The optionee gave notice of his exercise of the option, but failed to follow the agreed provisions governing determination of the price. Thereafter, more than a year later but still within the option period, he again attempted to exercise the option and to comply with the option contract valuation provisions. The refusal by the trial court to grant specific performance was held not to be an abuse of discretion. The court of civil appeals stated that time was "of the essence," and the optionee therefore had failed to comply with the conditions of the agreement within a reasonable period. With specific performance foreclosed, the optionee might now sue for damages, though how damages might be measured is uncertain.

Piercing the Corporate Veil. Texas courts continue to struggle with unsatisfactory doctrines as to when the corporate entity will be ignored. Despite a rather helpful opinion by the Texas supreme court which was described in last year's *Survey*,¹¹³ the courts still fail to articulate the bases of their decisions and rely instead on catch phrases which shed little or no light on the reasons underlying specific holdings.

A good example is *Western Rock Co. v. Davis*.¹¹⁴ Stroud and Fuller were directors, officers and shareholders of Western Rock Company, a corporation engaging in blasting operations which damaged property of others. Stroud actually supervised the blasting operations. Fuller supplied funds to the corporation either directly or by arranging bank loans; he permitted the blasting operations to continue even though he was aware that they were causing damage. He also managed corporate affairs for a brief period. The physical assets of Western Rock were leased from Fuller or from a family corporation owned by Fuller. Apparently the financial affairs of Western Rock gradually deteriorated, since by the time recoveries for the damaged property were obtained against Western Rock, the assets of the corporation had all been reclaimed by Fuller's family corporation. The insurance and other assets of the corporation were insufficient to pay the judgments. In holding Fuller and Stroud personally liable, the court of civil appeals said:

It appears obvious from the record that appellees' cause of action against Fuller is based upon ample proof that he was the dominating force behind Western Rock, a shell corporation, which had no assets and was in financial difficulty. That the corporation served as a device through which Fuller and Stroud could carry on destructive blasting activities at the expense of the property owners of Jacksboro, and at the same time be personally insulated from legal and financial responsibility against wrongs which were knowingly permitted, directed and controlled by them through the corporation device.¹¹⁵

The court then cited several cases involving attempts to disregard the corporate entity in contract cases, and concluded by citing oft-quoted

¹¹³ The decision is *Bell Oil & Gas Co. v. Allied Chem. Corp.*, 431 S.W.2d 336 (Tex. 1968), discussed in *Amsler, Corporations, Annual Survey of Texas Law*, 23 Sw. L.J. 98, 101 (1969).

¹¹⁴ 432 S.W.2d 555 (Tex. Civ. App.—Fort Worth 1968).

¹¹⁵ 432 S.W.2d at 558.

statements that the corporate entity will be disregarded if it is organized as a "mere tool or business conduit," or is relied on "to justify wrong," or is used as a "means of perpetrating fraud."¹¹⁶

The result reached by this case seems entirely sound on the facts even though the rationalization of the court is not very helpful. The following comments may help to put the result reached in perspective:

(a) It appears that Stroud (and probably Fuller) actually committed tortious acts or supervised other persons who actually committed such acts. They should therefore be personally liable. The fact that they were also agents of a corporation only means that the corporation is also liable; it does not protect them from tort liability for their own acts. On the same theory, a corporate agent who negligently drives an automobile while engaged in corporate business is personally liable for any injuries he causes. Thus, this case probably could have been decided on simple tort principles without any reference to "piercing the corporate veil."

(b) In cases such as this, a sharp distinction should be drawn between claims based on contract and claims based on tort.¹¹⁷ In contract cases, the plaintiff usually has dealt in some way with the corporation, and often is aware that the corporation lacks assets. In the absence of some sort of deception, a contract creditor therefore usually has little cause for complaint if the corporation becomes insolvent. In a sense, by dealing with a "shell corporation" without insisting on a guarantee by a financially secure person, the third person voluntarily assumes the risk of loss. In tort cases, on the other hand, the creditor usually has not had prior dealings with the corporation, but rather becomes a creditor against his will when injured by the tortious conduct. It may be unreasonable for a person to transfer the risk of loss for tortious conduct to the general public. For this reason, in tort cases courts should be more liberal in refusing to recognize the corporate entity. In the case under discussion, for example, at least two reasons for refusing to recognize the separate corporate existence of Western Rock Company might be suggested:

(i) It is against public policy for a corporation to engage in inherently risky conduct such as blasting without a considerable amount of financial stability (either in the form of assets or insurance). A person engaging in conduct with such a high likelihood of causing harm to others should not be allowed to avoid liability merely by conducting business through a nominally capitalized corporation.¹¹⁸ In this argument, the nature of the business forms the basis for decision.

¹¹⁶ Language to this general effect appears in numerous cases, including *Pacific Am. Gasoline Co. v. Miller*, 76 S.W.2d 833 (Tex. Civ. App.—Amarillo 1934), *error ref.*

¹¹⁷ The recent supreme court opinion in *Bell Oil & Gas Co. v. Allied Chem. Corp.*, 431 S.W.2d 336 (Tex. 1968), suggests this distinction.

¹¹⁸ It is sometimes objected that the legislature rather than the courts should formulate a public policy of the nature suggested. However, a decision either way in effect establishes a public policy, so that judicial formulation of policy is unavoidable. Also, courts do respond regularly to notions of public policy, and it is unrealistic to assume that they do not or should not. For example, in the case under discussion, the court was clearly influenced by the fact that a nominally capitalized corporation was engaging in the risky business of blasting. Is it not better for the courts to articulate the true basis of their decisions rather than hiding in meaningless rhetoric?

The New York courts have intimated that the incorporation statutes establish a public policy

(ii) Fuller may have acted unfairly by failing to buy insurance or by permitting the corporation's financial affairs to deteriorate while retaining a lessor's interest in the operating assets of the corporation. By this device, not even the operating assets were available to satisfy tort claimants. In this argument, the way the business was conducted forms the basis for decision.

Three cases decided during the survey period highlight the fact that corporations are separate entities distinct from their officers, directors, shareholders, and other corporations under common ownership. These cases may be conveniently considered at this point.

Many retail chain stores consist of a parent corporation and numerous subsidiary corporations, each operating a single store. The Sage chain conducts business in such a fashion. The parent corporation is Sage, Inc., International, while the Dallas store is operated by Sage, Inc. of Dallas, and the Houston store is operated by S.A.G.E., Inc. of Houston. When suit is brought against a corporation in such a chain it is obviously important that the attorney ascertain that he is naming the proper corporate defendant. In *Lunsford v. Sage, Inc. of Dallas*¹¹⁹ the plaintiff brought suit against the Dallas corporation for false imprisonment arising out of an incident in the Houston store. He apparently was misled in this regard by employees of Sage. An answer on the merits was filed by defendant's attorney without reference to the error of naming the wrong corporation as defendant. After the statute of limitations had expired, the answer was amended, denying that the corporate defendant owned the Houston store. The plaintiff attempted to amend his pleadings to name the proper defendant, but the court of civil appeals held that the statute of limitations prevented him from doing so. Moreover, the court held that the named defendant was not estopped by its earlier representations and pleadings from denying that it owned the store in question. The plaintiff was, therefore, out of court. Putting aside comment on the propriety of the actions of the defendant's attorney in this case, or the correctness of the court's ruling on the estoppel issue, the basic lesson is clear: make sure you sue the correct corporation.

A similar lesson may be drawn from *Electrical Contracting & Maintenance Co. v. Perry Distributors, Inc.*¹²⁰ Fuller, the president of Electrical Contracting & Maintenance Company, Inc., called Perry Distributors, Inc. to order certain appliances for an apartment project owned by Fuller personally. Fuller asked that the bill be sent to the corporation; it was unclear whether the bill was to be sent to Fuller at the corporate address or to the corporation itself, which was doing some work on the pro-

permitting nominally capitalized corporations to enter into a risky business such as operating a taxicab in New York City. *Walkovsky v. Carlton*, 18 N.Y.2d 414, 223 N.E.2d 6, 276 N.Y.S.2d 585 (1966). In contrast, California takes the view that a corporation, to be recognized, must be established with sufficient capital reasonably to cover probable liabilities in the particular line of business. *Minton v. Cavenev*, 56 Cal. 2d 576, 364 P.2d 473, 15 Cal. Rptr. 641 (1961). Thus, there is sharp disagreement in the two most populous states as to the appropriate public policy in this area.

¹¹⁹ 438 S.W.2d 615 (Tex. Civ. App.—Houston 1969), *error ref. n.r.e.*

¹²⁰ 432 S.W.2d 543 (Tex. Civ. App.—Dallas 1969), *error ref. n.r.e.*

ject. Plaintiff's complaint alleged that Fuller had purchased the appliances and stated that the defendant corporation was named "for the reason that the Defendant Fuller, as owner and president of said corporation, directed Plaintiff to send a bill to the said corporation, inasmuch as it had the electrical subcontract on the apartment project."¹²¹ However, the case was submitted to the jury on the theory that the corporation was the purchaser, acting through its president, by express or implied contract. This variance between allegation and submission resulted in a reversal and remand to consider Fuller's personal liability for the appliances. Here again, failure to distinguish sharply between the corporation and the individual resulted in an avoidable and expensive appeal.

Also of interest is *Schaffer v. Universal Rundle Corp.*,¹²² in which the Fifth Circuit held it improper in an antitrust case to join a sole shareholder as plaintiff when only the corporation had been injured. The court felt that joining the shareholder might result in an inflation of the size of the award.

Fiduciary Duties. Three cases involving fiduciary duties owed by directors to their corporations were decided during the survey period. In *Reynolds-Southwestern Corp. v. Dresser Industries, Inc.*¹²³ the court of civil appeals applied a fairness test to determine the enforceability of a contract between two corporations with common directors. The court also stated, in a questionable dictum, that enforcement of such contracts "is not favored by the law." In this case, Beeman and Parker, on the one hand, and Reynolds, on the other, agreed to enter into a joint venture, in corporate form, to market an invention owned by Reynolds. The result was the creation of Reynolds-Southwestern Corporation. Reynolds was issued fifty per cent of the shares and a corporation owned by Beeman and Parker, Southwestern Industrial Electronics Company, owned the balance. Reynolds, Beeman and Parker were directors of Reynolds-Southwestern and Beeman and Parker were directors of Southwestern Industrial. Several years later the parties agreed to terminate their relationship, and the contract in dispute, between Reynolds-Southwestern and Southwestern Industrial, was executed to reflect this settlement. Reynolds-Southwestern thereafter stopped making payments required by the settlement on the ground of fraud. The court of appeals held that issues of fact should have been submitted to the jury to determine whether Beeman and Parker had acted in good faith, and whether the contract was a fair one. In addition, the court stated that fiduciary duties also existed between the parties because they were joint venturers, despite the formation of a corporation.¹²⁴

¹²¹ *Id.* at 545.

¹²² 397 F.2d 893 (5th Cir. 1968).

¹²³ 438 S.W.2d 135 (Tex. Civ. App.—Houston 1969), *error ref. n.r.e.*

¹²⁴ Compare the following dictum from *Colonial Refrigerated Transp., Inc. v. Mitchell*, 403 F.2d 541, 548 (5th Cir. 1968):

There is authority that, when parties choose to do business as a corporation and thus gain the advantage of the corporate business form, including limited liability, they cease to be joint venturers and thereafter have only the rights, duties, and obligations of stockholders. These cases reason that the investors "are not at one and the same time

The second case, *Wortham v. Lachman-Rose Co.*,¹²⁵ involved the duties of the directors of an insolvent corporation to the creditors of the corporation. Stating that the assets of an insolvent corporation constitute a "trust fund" for the benefit of creditors,¹²⁶ the court of civil appeals required the directors to restore to the corporation money they had paid to themselves in satisfaction of a claim. The claim the directors satisfied arose from their payment of certain corporate debts which they had guaranteed. The trust fund theory developed in this case would appear to prevent the directors of an insolvent corporation from making a preferential payment to any creditor.¹²⁷

In the final case, *Stockton v. Lake Tanglewood & Skybolt, Inc.*,¹²⁸ the court cancelled a deed from a corporation to one of its directors on the ground of "unfairness and lack of consideration." Apparently, the other directors were unaware of the conveyance.

Miscellaneous. Several miscellaneous decisions involving corporations should be noted. The Austin court of civil appeals¹²⁹ held that a small business investment company was not exempt from the franchise tax as a "mutual investment company."¹³⁰

The Texas venue statute¹³¹ permits suit to be brought against a corporation in several different counties: (a) in the county in which the corporation's registered office is located,¹³² (b) in the county in which the corporation's "principle office" is situated, (c) in the county in which the cause of action or part thereof arose, (d) in the county in which the plaintiff resided when the cause of action arose, provided the corporation has an "agency or representative" in the county, or (e) if the corporation has no "agency or representative" in the county of the plaintiff's residence, then in the county nearest to the one in which plaintiff resided in which the corporation has an "agency or representative."¹³³ Questions continue to arise relating to the proper application of these provisions. In *Sani-Serv*

joint venturers and stockholders, fiduciaries and nonfiduciaries, personally liable and not personally liable.' However, there is also persuasive and well-reasoned authority that a joint venture agreement continues in effect following the formation of a corporation created to implement it if the parties' intention to this effect is clear.

Apparently, the Texas courts have never had occasion to adopt either view . . .

¹²⁵ 440 S.W.2d 351 (Tex. Civ. App.—Houston 1969).

¹²⁶ This language appears in *Lyons-Thomas Hardware Co. v. Perry Stove Mfg. Co.*, 86 Tex. 143, 24 S.W. 16 (1893).

¹²⁷ See *Waggoner v. Herring-Showers Lumber Co.*, 120 Tex. 605, 40 S.W.2d 1 (1931).

¹²⁸ 441 S.W.2d 575 (Tex. Civ. App.—Amarillo 1969). Another portion of this opinion holds that a corporation is bound by its officer's knowledge respecting a transaction in which the corporation was represented by the officer in question.

¹²⁹ *Calvert v. Capital Sw. Corp.*, 441 S.W.2d 247 (Tex. Civ. App.—Austin 1969), *error ref. n.r.e.*

¹³⁰ TEX. REV. CIV. STAT. ANN. art. 12.03 (1969). Small business investment companies are formed under the TBCA, registered under the Federal Investment Company Act of 1940, and licensed under the Small Business Investment Act of 1958. They invest in obligations of small business firms and exercise some degree of control over the portfolio companies.

¹³¹ *Id.* art. 1995(23).

¹³² See *Ward v. Fairway Operating Co.*, 364 S.W.2d 194 (Tex. 1963).

¹³³ This list is not exclusive. For example, if two defendants are involved, both may be sued in a county in which venue is proper for either. TEX. REV. CIV. STAT. ANN. art. 1995(4), (29a) (1964).

The Texas venue statutes are discussed in VanDercreek, *Texas Civil Procedure, Annual Survey of Texas Law*, 23 Sw. L.J. 177, 185 (1969); *id.*, 21 Sw. L.J. 155, 158 (1967).

*Freezer Sales, Inc. v. Coker*¹³⁴ the court of civil appeals held, in a breach of contract case, that venue was proper under clause (c) where suit was brought in a county (1) in which it was conceded that the contract was made, and (2) in which the defendant breached a warranty made in the contract. In *Hydrostatic Engineers, Inc. v. Rapid Service, Inc.*¹³⁵ the court held that venue was proper in a contract case in the county where, pursuant to the contract, the plaintiff deposited money to the defendant's account, and suit was for its recovery. Finally, in *Cotton Concentration Co. v. A. Lassberg & Co.*,¹³⁶ the court held that Cotton Concentration Company maintained an "agency or representative" in Dallas County under clauses (d) and (e) under the following circumstances:

The Cotton Exchange Building in Dallas County is an office building occupied primarily by cotton merchants engaged in buying and selling cotton, who are customers or potential customers of appellant. . . . [F]or more than thirty-eight years appellant has leased an office in the Cotton Exchange Building Its office is listed in the building directory and in the telephone directory in the name of appellant, Cotton Concentration Company, Inc. . . . [A]ppellant has maintained William Brown, a salaried member of its staff, in its Dallas office where he has been accessible to look after its business in the Dallas area. . . . Brown was authorized to and did solicit business on appellant's behalf and represented appellant in handling business problems that arose in dealings between the cotton merchants in the area and appellant's warehouse in Galveston. . . . Brown maintained in his office in Dallas regular business files including correspondence, records and warehouse receipts when delivered to him, and other business records which came through his office. Possession of warehouse receipts by Brown was regarded by appellant as its own possession.¹³⁷

The court rejected the argument that an agent with power to contract for the principal was necessary to constitute an "agency or representative" under the venue statute.

Several cases illustrate little more than that corporations have to "cut square procedural corners" in Texas. Many of these cases involve mistakes or carelessness by attorneys. In *Globe Leasing, Inc. v. Engine Supply & Machine Service*¹³⁸ an appeal by a corporation was dismissed in part on the ground that the president of the corporation (who was not an attorney) had filed an answer and appeared on behalf of the corporation. The court of civil appeals held that the right of an individual to appear in person does not extend to a corporation which may appear only through a licensed attorney. In *Diamond Chemical Co. v. Sonoco Products Co.*¹³⁹ a sheriff's citation that service had been executed by "delivering to each of the within named defendants" a copy of the citation and complaint "at the following times and places, to wit: Diamond Chemical Co., Inc. by serving Burton B. Jones 11-20-67 8:10 a.m." was held insufficient to support a

¹³⁴ 441 S.W.2d 649 (Tex. Civ. App.—Tyler 1969).

¹³⁵ 439 S.W.2d 866 (Tex. Civ. App.—El Paso 1969), *error dismissed*. In this case the court also held that venue was proper under TEX. REV. CIV. STAT. ANN. art. 1995(5) (1964).

¹³⁶ 433 S.W.2d 736 (Tex. Civ. App.—Eastland 1968).

¹³⁷ *Id.* at 740.

¹³⁸ 437 S.W.2d 43 (Tex. Civ. App.—Houston 1969).

¹³⁹ 437 S.W.2d 308 (Tex. Civ. App.—Corpus Christi 1968).

default judgment because it failed to show "the manner of service."¹⁴⁰ In a similar case,¹⁴¹ service on "Bankers Life & Casualty Co. by serving its agent Everett Hall" was held insufficient to support a default judgment against a foreign corporation because the record failed to show that Hall fell within one of the categories of agents referred to in articles 2031 or 2031a.¹⁴² In *Curry v. Dell Publishing Co.*¹⁴³ service on a foreign corporation through the Secretary of State was held inadequate because of failure to allege necessary facts under the Texas Long Arm Statute.¹⁴⁴ The further argument that attempted removal of the case to the federal court constituted a general appearance was also rejected. In another case, the Texas Long Arm Statute was held to be not long enough to reach a New York corporation whose only contact with Texas was the receipt of orders in New York by mail or plane from Texas and the shipping of merchandise from New York to Texas by turning the goods over to an independent carrier in New York.¹⁴⁵

Finally, two cases involved the power of a corporation, whose charter has been forfeited for nonpayment of franchise taxes, to maintain suit in Texas courts. In *Texas Machinery & Equipment Co. v. Gordon Knox Oil & Exploration Co.*¹⁴⁶ the Texas Machinery & Equipment Company assigned all its assets to certain foreign corporations in 1962; among the assets so assigned was a suit against one Montgomery. A judgment was shortly thereafter obtained in the name of Texas Machinery but was not satisfied. The company was apparently then abandoned. Its charter was forfeited for nonpayment of franchise taxes in 1963. In 1967, the assignees were given cause to believe that Gordon Knox Oil & Exploration Co. might be indebted to Montgomery. Garnishment proceedings were then instituted in the name of Texas Machinery & Equipment Company and Gordon Knox permitted a default judgment to be entered against it.¹⁴⁷ In a proceeding to set aside the default judgment, it was argued that the statutory provisions closing Texas courts to corporations whose charters have been defaulted for failure to pay franchise taxes¹⁴⁸ precluded a garnishment proceeding in the name of the defaulted corporation. The Texas supreme court rejected this argument on the theories that (a) an assignee may proceed in the name of an assignor even though the assignor has dissolved, and (b) the procedure followed was consistent with the general practice of issuing ancillary process in the name of the party in whose favor the judg-

¹⁴⁰ TEX. R. CIV. P. 107. The court relied primarily on *Hyltin-Manor Funeral Home v. Hill*, 304 S.W.2d 469 (Tex. Civ. App.—San Antonio 1957), which points out that the manner of service might involve reading the citation or leaving a copy at the defendant's residence.

¹⁴¹ *Bankers Life & Cas. Co. v. Watson*, 436 S.W.2d 404 (Tex. Civ. App.—Tyler 1968), *error ref. n.r.e.*

¹⁴² TEX. REV. CIV. STAT. ANN. arts. 2031, 2031a (1964).

¹⁴³ 438 S.W.2d 887 (Tex. Civ. App.—El Paso 1969), *error dismissed*.

¹⁴⁴ TEX. REV. CIV. STAT. ANN. art. 2031b (1964).

¹⁴⁵ *Bodzin v. Regal Accessories, Inc.*, 437 S.W.2d 655 (Tex. Civ. App.—Dallas 1969), *error ref. n.r.e.*

¹⁴⁶ 442 S.W.2d 315 (Tex. 1969).

¹⁴⁷ *Gordon Knox* was not in fact indebted to Montgomery. The company permitted the judgment to be entered because the Secretary-Treasurer of that company was unaware that it was necessary to file an answer even though no indebtedness existed.

¹⁴⁸ TEX. REV. CIV. STAT. ANN. art. 12.14 (Supp. 1968).

ment was rendered.¹⁴⁹ In effect, the supreme court recognized that the assignees rather than the dissolved corporation were the real party in interest. In contrast, in *Radar Leasing Corp. v. Wholesome Dairy, Inc.*,¹⁵⁰ the corporation had assigned all its assets, *other than the claim on which suit was brought*, forfeited its charter for nonpayment of franchise taxes, and then attempted to bring suit on the claim. Not surprisingly, the court of civil appeals held that the suit was barred unless the corporation paid the delinquent franchise taxes owed to the state of Texas.

¹⁴⁹ The court also held that the negligence of the Gordon Knox Company in failing to answer the garnishment was not excusable. The court of civil appeals, in *Texas Mach. & Equip. Co. v. Gordon Knox Oil & Exploration*, 434 S.W.2d 182 (Tex. Civ. App.—Amarillo 1968), had held that the failure to pay the franchise taxes barred the suit, though the court may partially have been motivated by other considerations, since it stated that there was no "evidence in this case that the appellants were representing [the assignees] in their effort to take \$11,080.00 away from a completely innocent party."

¹⁵⁰ 442 S.W.2d 467 (Tex. Civ. App.—El Paso 1969).