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THE REQUIREMENT OF MINIMUM PAID-IN CAPITAL

THE most substantial condition precedent to legal existence of a general business corporation imposed by Texas statutes is that set forth in Article 1308 which requires that "before the charter of a private corporation created for profit can be filed by the Secretary of State, the full amount of its authorized capital stock must be in good faith subscribed by the stockholders, and fifty percent thereof paid in cash or its equivalent in other property or labor done, the product of which shall be worth to the company the actual value at which it was taken or at which the property was received."¹ Although the minimum paid-in capital requirement differs in the case of corporations chartered under statutory provisions other than those of this title,² where the nature

¹ TEX. REV. CIV. STAT. ANNO. (Vernon, 1925) art. 1308: "The affidavit of those who executed the charter shall be furnished to the Secretary of State showing the name, residence, and post office address of each subscriber to the capital stock of such company; the amount subscribed by each and the amount paid by each; the cash value of any property received, giving its description, location and from whom and the price at which it was received; the amount, character, and value of the labor done, from whom and price at which it was received." See *Furr v. Chapman*, 286 S. W. 171 (Comm. App. 1926). These prerequisites do not apply to corporations formed under the articles discussed in note 2 *infra*. Upon the submission of the charter, it is within the discretion of the Secretary of State whether it shall be filed. *Beach v. McKay*, 108 Tex. 224, 191 S. W. 557 (1917); *cf. Smith v. Wortham*, 106 Tex. 106, 157 S. W. 740 (1913); Note (1929) 7 TEX. LAW REV. 651. He may require information as to the fulfillment of the statutory provisions in addition to the affidavits of those persons who have executed the charter. TEX. REV. CIV. STAT. ANNO. (Vernon, 1925) art. 1309. When the Secretary of State deems it acceptable, the original copy is filed in his office and a de jure corporation is then in existence. TEX. REV. CIV. STAT. ANNO. (Vernon, 1925) art. 1313.

² A no par stock corporation is exempt from articles 1308-11 inclusive and article 1338. TEX. REV. CIV. STAT. ANNO. (Vernon, 1925) art. 1538j. Article 1538d provides that 10 per cent of the shares to be issued must be subscribed and paid in in good faith, in no event to be under twenty-five thousand (\$25,000) dollars. This type of corporation is also exempt from the requirement that all of the authorized capital stock must be paid in within two years after the articles of incorporation are filed. The company can continue to do business without ever having 90 per cent of their authorized capital stock sold or paid for, since there is no proviso stating when the balance of the stock must be subscribed or paid.

Other corporations exempt from these provisions are those companies chartered under art. 1302, §§ 48, 67, 68, 71, and 72, and art. 1310. Corporations thus exempted are those formed for the following purposes: to accumulate and lend money without banking or discounting privileges (art. 1302, § 48); construction, operation and maintenance of

of the corporate enterprise has been deemed to warrant modification of the fifty percent requirement, the problems presented by such statutes are substantially the same as those raised by Article 1308.

Foreign corporations desiring a permit to do business in Texas must first show "to the satisfaction of the Secretary of State that at least one hundred thousand dollars in cash of their authorized capital stock has been paid in, or that fifty percent of their authorized capital stock has been subscribed, and at least ten percent thereof paid in."³

EFFECT OF ARTICLE 1308 ON CORPORATE EXISTENCE

Under the statute in force prior to the adoption of Article 1308,⁴ the Supreme Court of Texas held⁵ that the *de jure* existence of a corporation was independent of the subscription or payment of a minimum amount of capital stock. Under the present statute, however, it is emphasized that a corporation is a creature of

street car and railway depots (*id.*, § 67); lines of electric gas or gasoline railways and interurban railways between cities and towns (*id.*, § 68); railroads to mines, gins, quarries, manufacturing plants and mills (*id.*, § 71); terminal railways, (*id.*, § 72); construction, purchase and maintenance of mills and gins having a capital stock of not exceeding fifteen hundred dollars (art. 1310); mutual building and loan associations (*ibid.*); construction, purchase and maintenance and operation of cotton mills (*ibid.*); waterworks, ice plants, electric light plants, and cotton warehouses in cities of less than ten thousand inhabitants (*ibid.*); corporations must have one hundred thousand dollars of their authorized capital stock paid in, or have 50 per cent subscribed and 10 per cent paid in to commence business. TEX. REV. CIV. STAT. ANNO. (Vernon, 1925) art. 1311.

Corporations formed for the purpose of owning abstract plants, insuring titles, lending money, dealing in securities, and acting as trustees are required to have a paid-up capital of not less than one hundred thousand dollars before they may obtain a certificate to transact business. *Id.*, art. 1302a, § 2.

When forming an insurance corporation the capital stock must be all subscribed and paid for; a signed affidavit to that effect must be placed in the hands of the Commissioner of Insurance. *Id.*, art. 4718. A general casualty insurance company must have a capitalization of at least one hundred thousand dollars and fifty thousand dollars for every kind of insurance over one which it is authorized to handle. A minimum limit of two hundred thousand dollars has been placed on this proviso to allow the company to handle any and all types of insurance. *Id.*, art. 4993.

³ TEX. REV. CIV. STAT. ANNO. (Vernon, 1925) art. 1530. The constitutionality of this statute was determined by the Supreme Court in *English and Scottish American Mortgage and Investment Co., Ltd. v. Hardy*, 93 Tex. 289, 55 S. W. 169 (1900).

⁴ 8 LAWS OF TEXAS (Gammel, 1894) 120 (§ 14). This statute had no prerequisite regarding minimum paid-in capital.

⁵ *National Bank v. Texas Investment Co.*, 74 Tex. 421, 12 S. W. 101 (1889).

statute and that all the prescribed formalities which relate to the essentials of corporate existence must unquestionably be followed.⁶

The question then arises whether or not these conditions must be complied with in the creation of a *de facto* corporation. The requisites for the latter are (a) the existence of a law under which a corporation with the powers assumed might lawfully be created; (b) a bona fide effort to incorporate thereunder; and (c) an actual user of the rights claimed to be conferred by such law. As against all persons except the state, a *de facto* corporation has the same power and is subject to the same operations as a corporation *de jure*.⁷ One Court of Civil Appeals has said⁸ that the requisites in Article 1308 were established to show actually how much stock had been subscribed for, paid in, and the manner in which it was paid, and then charged the Secretary of State with the duty of ascertaining whether such amounts had been paid and the correctness of the value.⁹ In states where minimum paid-in capital is not a condition precedent to incorporation but only a condition precedent to commencing of business, several cases which have held that failure to comply with these requirements did not prevent the existence of a *de facto* corporation¹⁰ have con-

⁶ See BALLANTINE, PRIVATE CORPORATIONS (1927) 58-9.

The requirement as to the payment of stock does not regulate the issuance of stock governed by TEX. CONST. (1876) Art. XII, § 6. *McCarthy v. Texas Loan and Guaranty Co.*, 142 S. W. 96 (Tex. Civ. App., 1912).

⁷ See *Roaring Springs Townsite Co. v. Paducah Telephone Co.*, 164 S. W. 50, 55 (Tex. Civ. App. 1919), *aff'd*, 109 Tex. 452, 212 S. W. 147 (1919).

Articles 1304 and 1308 declare specifically what acts are necessary to bring a corporation into existence; these prerequisites are mandatory for either a *de facto* or a *de jure* corporation. A body which cannot become a *de jure* corporation cannot become a *de facto*. *Gordon v. American Patriots*, 141 S. W. 331 (Tex. Civ. App. 1911); Note (1925) 37 A. L. R. 1319.

⁸ *Thomason v. Miller*, 4 S. W. (2d) 668 (Tex. Civ. App. 1928).

⁹ TEX. REV. STAT. ANNO. (Vernon, 1925) art. 1309.

¹⁰ *Minor v. Mechanic's Bank*, 1 Pet. 46 (U. S. 1828); *Temple Enterprise, Inc. v. Combs*, 164 Ore. 133, 100 P. (2d) 613 (1940); *Washington Coop. Egg and Poultry Association v. Taylor*, 122 Wash. 466, 210 Pac. 806 (1922); Note (1926) 40 A. L. R. 1511. Contra: *Eastern Products Corporation v. Tennessee Coal, Iron and RR. Co.*, 151 Tenn. 239, 269 S. W. 4 (1925).

tained dicta that the result would be otherwise under a statute similar to Article 1308.

However, the Texas Courts of Civil Appeals are in apparent conflict as to whether a de facto corporation would exist if there were a failure to comply with the minimum payment requirement.¹¹ They have held with the subsequent approval of the Supreme Court of Texas that performance of all the prerequisites short of filing the charter is not sufficient to bring the company into existence either as a de jure or a de facto corporation.¹² And in *Shaw v. Kopecky*,¹³ the court held that failure to regard the requirement conclusively forestalled any application of the rules of law pertaining to a de facto corporation. Yet in *Scharbauer v. Lampases Co.*,¹⁴ it was held that payment for fifty percent of the capital stock is not essential to the creation of a de facto corporation where failure to make such payment was not fraudulent, and recognized de facto existence where the notes of the subscribers were taken as payment for the shares. And another court has said that failure to comply with the minimum paid-in capital requirement alone does not render the incorporation void.¹⁵ In *Payne v. Bracken*,¹⁶ the Supreme Court said:

“... whether after filing the charter, the corporation is one de facto or de jure depends upon compliance or not by the incorporators with all the conditions prescribed by the laws essential to give life and vitality

¹¹ Where an Indiana statute provided for subscription and payment of one-fourth of the capital stock of a company before incorporation, *Sterne v. Fletcher American Co.*, 204 Ind. 35, 181 N. E. 37 (1932), held that the purported company was neither a de jure or a de facto corporation.

¹² Minority view: *Payne v. Bracken*, 131 Tex. 394, 115 S. W. (2d) 903 (1938); *Bank of Desota v. Reed*, 50 Tex. Civ. App. 102, 109 S. W. 257 (1908). Majority rule: *Tisch Auto Supply Co. v. Nelson*, 222 Mich. 196, 192 N. W. 600 (1923); Note (1925) 37 A. L. R. 1319; Note (1923) A. L. R. 376.

¹³ 27 S. W. (2d) 275 (Tex. Civ. App. 1930).

¹⁴ 235 S. W. 533 (Tex. Comm. App. 1921). This result was reached although it has been held several times that stock could not be paid for by means of an unsecured note in Texas. *Washer v. Smyer*, 109 Tex. 398, 211 S. W. 985 (1919); *Mason v. First National Bank of Paint Rock*, 156 S. W. 366 (Tex. Civ. App. 1913); Note (1928) TEX. L. REV. 215.

¹⁵ *Mayfield v. First Natl. Bank of Holland*, 19 S. W. (2d) 454 (Tex. Civ. App. 1929).

¹⁶ 90 S. W. (2d) 607 (Tex. Civ. App. 1936), *aff'd*, 131 Tex. 394, 115 S. W. (2d) 903 (1938).

to the association as a corporation. While filing of the charter makes it a corporation, the failure to comply with some one or more of the prerequisites makes it a corporation de facto."

From the requisites laid down for the existence of a de facto corporation, it seems clear that where the incorporators did not comply with the minimum paid-in capital requirement, they could not then plead that they had made a bona fide effort to incorporate under the laws of Texas.¹⁷ It would seem that these mandatory requirements should be complied with in order that the corporation come into existence.¹⁸ But after the State has certified the charter and so recognized the legal existence of a corporation, it would be contrary to public policy to allow a private individual to initiate an inquiry into the validity of an act of the State in a proceeding to which the State is not a party.¹⁹ The validity and legal existence of a corporate organization under the statutes can only be questioned by the State in quo warranto proceedings had for that purpose.²⁰

¹⁷ Judge Marr said in *Allen v. Long*, 80 Tex. 266, 16 S. W. 45, 26 Am. St. Rep. 735 (1891): "It is only where there has been an effort to conform to the forms of law in establishing a corporation, and some formal defect exists merely as to the mode of complying with the law, and the body is dealt with and acts as a corporation, that it is regarded as one de facto." See also *Mokelumne Hill Canal and Mining Co. v. Woodbury*, 14 Cal. 424, 73 Am. Dec. 658 (1859).

The Kansas City Court of Appeals in *Journal Co. v. Nelson*, 133 Mo. App. 482, 113 S. W. 690 (1908), held that a charter obtained through fraud from the Secretary of State is void and subject to collateral attack. But the Supreme Court of Missouri overruled this proposition in *Webb v. Rockefeller*, 195 Mo. 57, 93 S. W. 777 (1906), saying that the courts are bound to regard a company, incorporated according to all the required forms of law, as a corporation so far as third parties are concerned until it is dissolved by judicial proceedings on behalf of the government which created it. It is a fraud on the state.

¹⁸ 1 HILDEBRAND, TEXAS CORPORATIONS (1942) 411.

¹⁹ *Sayers v. Navellus Oil Co.*, 41 S. W. (2d) 506 (Tex. Civ. App. 1931). Without stating that the corporation is a de facto corporation, the courts have also held that a person who enters into a contract with a corporation as such is estopped to deny its corporate existence in an action against him. See TEX. REV. CIV. STAT. ANNO. (Vernon, 1925) art. 1317. When persons sign the corporate charter and affidavits that the stock has been fully paid for, they may be held to a performance of their subscription agreement by the state or the corporation. *Stringfellow v. Panhandle Packing Co.*, 213 S. W. 250 (Tex. Comm. App. 1919); *Peden Iron and Steel Co. v. Jenkins*, 203 S. W. 180 (Tex. Civ. App. 1918).

²⁰ *Mayfield v. First National Bank of Holland*, 19 S. W. (2d) 454 (Tex. Civ. App. 1929); see TEX. REV. CIV. STAT. ANNO. (Vernon, 1925) art. 1317; *Parks v. West*, 102 Tex. 11, 111 S. W. 726 (1908); *Conley v. Daughters of the Republic of Texas*, 151 S. W.

HISTORY AND PURPOSE OF ARTICLE 1308

The basis of these statutes can be traced to the beliefs brought to America by the original colonists. In the seventeenth century, the English people reacted violently against corporations, when because of misuse and corruption nearly all of those original corporate enterprises failed. "The complication of credulity and dishonesty, of ignorance and avarice, threw England into a positive frenzy."²¹ In the Constitutional Convention, the Colonies were completely limited by their experience of corporations as wholly dependent upon a franchise from the State, and they greatly feared the institution, making in general, little attempt to discover or use any of its latent possibilities.²²

At first, corporations could only be formed by a special act of the Legislature; but this became too tremendous a task and general provisions were made.²³ The fundamental conception was that the capital of the corporation was a trust fund to insure to the creditors the right of payment.²⁴ The corporation was not at liberty to do what it desired with this capital stock and credit was universally given to this fund as the only means of payment.

The modern view is that the underlying purpose of corporate organization is to insure effective endeavor with safeguards limiting this power to protect the savings of innocent shareholders and the property of credulous creditors. Morawetz in Section 137 of his work on Corporations, states that the "object of fixing the capital of a corporation at a definite sum is to indicate the scope

877 (Tex. Civ. App. 1912), *rev'd on other grounds*, 106 Tex. 80, 157 S. W. 937 (1913). TEX. REV. CIV. STAT. ANNO. (Vernon, 1925) art. 1387 provides that the Attorney General shall bring proceedings to forfeit the charter of any corporation if illegality in formation is found.

²¹ See BISHOP, THE FINANCING OF BUSINESS ENTERPRISES (1929) 57. This reaction resulted in passage of what is commonly called the "Bubble Act," 6 GEO. I, c. 18, § 8. In brief, the new law made it illegal to form a corporation except under what were thought to be proper safeguards.

²² See BERLE, STUDIES IN THE LAW OF CORPORATE FINANCE (1928) 15.

²³ TEX. CONST. (1876) ART. XII, § 1.

²⁴ See THATCHER, CAPITAL AND CAPITAL STOCK (1891); 25 A. L. R. 940. *Accord*: National Bank v. Texas Investment Co., 74 Tex. 421, 12 S. W. 101 (1889); Thompson v. First State Bank of Amarillo, 109 Tex. 419, 211 S. W. 977, 987 (1919).

of the company's business and the amount of capital deemed necessary for the transaction of the business contemplated. It indicates to the shareholders their fractional interests in the whole concern and the extent of the enterprise in which they are invited to join."²⁵

It is highly desirable that a corporation should come into existence with the majority of its shares of stock subscribed, the subscribers under a binding contract, and a minimum amount of capital to complete the organization which confers the right to create indebtedness. The charter relieves the individual stockholders from personal liability and substitutes capital stock in its stead—sufficient funds to enable the corporation to transact business on an efficient and profitable basis. Without sufficient capital, this cannot be done.

The Legislature in enacting these provisions set up the structure in order to protect the largest number of people involved.²⁶ They are to prevent fictitious corporations from obtaining money and property of the shareholder, and they also must be sufficient to protect those who establish financial relationship to the corporation before full financial strength has been obtained.²⁷ Other limitations have been put on corporate organization aside from the minimum paid-in capital requirement to further this aim.

Subscription to all the authorized capital stock is another step

²⁵ In *Turner v. Cattleman's Trust Co. of Ft. Worth*, 215 S. W. 831 (Comm. App. 1919), the court said that the term "capital" designates that portion of the assets of a corporation, regardless of their source, which is utilized for the conduct of business and for the purposes of deriving therefrom gains and profits.

²⁶ TEX. CONST. (1876) Art. XII, § 2: "General laws shall be enacted providing for the creation of private corporations, and shall therein provide fully for the adequate protection of the public and individual stockholders."

²⁷ See TAYLOR, FINANCIAL POLICIES OF BUSINESS ENTERPRISE (1942) 138.

In 1944, the most recent year for which statistics are reported in the TEXAS ALMANAC AND STATE INDUSTRIAL GUIDE (1945-6) 58, there were 672 corporations filed in the office of the Secretary of State with a total capitalization of \$11,211,000. Of these, 208 had an authorized capital stock of less than \$5,000, while 25 had a capital stock of more than \$100,000. The classification of corporations was as follows: banking and finance—16; manufacturing—69; merchandising—190; oil—45; public service—17; real estate and building—111; transportation—28; all other—196. The number of foreign corporations permitted to do business in Texas was 169.

preliminary to the organization of a corporation.²⁸ Before incurring the expenses of incorporation, promoters or incorporators must solicit subscriptions to stock in order to make certain that sufficient funds will be forthcoming to launch the enterprise successfully.

The stock subscription is a transaction between the subscriber and the company, and the obligation of one can only be sustained by the corresponding obligation of the other.²⁹ Under Article 1308, one half of the capital stock consists of subscriptions until, of course, realized upon in cash. This is the basis of credit and an essential to organization. The Supreme Court of Texas has held several times that the Texas Constitution prohibits the issuance of stock before complete payment has been made.³⁰ Under this ruling, when is the subscriber bound on his contract? It would seem in view of Article 1308 that the subscriber is bound at the time he enters into the subscription contract.³¹ Also, the subscriber cannot relieve himself from liability by conditions attached to such contract.³² Each subscriber need not pay fifty percent of

²⁸ TEX. REV. CIV. STAT. ANNO. (Vernon, 1925) art. 1308.

²⁹ See *Boroseptic Chemical Co. v. Nelson*, 53 S. D. 546, 221 N. W. 624 (1928).

³⁰ *Turner v. Cattleman's Trust Co. of Ft. Worth*, 215 S. W. 831 (Tex. Comm. App. 1919); *Kanaman v. Gahagan*, 111 Tex. 170, 230 S. W. 141 (1921); *Washer v. Smyer*, 109 Tex. 398, 211 S. W. 985 (1919); *Thompson v. First State Bank*, 109 Tex. 418, 211 S. W. 977 (1919).

³¹ The Texas rule is that of the minority. The two theories on which the Texas courts hold the subscriber liable are (1) that the contract is between the subscribers themselves to become stockholders without further action on their part and is immediately binding upon the formation of the contract, and (2) that it is a continuing offer to the proposed corporation which upon acceptance by it after its formation becomes, as to each subscriber, a contract between him and the corporation. The subscription contract is binding eo instanti. *Coleman Hotel Co. v. Crawford*, 3 S. W. (2d) 1109 (Tex. Comm. App. 1928). The weight of authority is that the subscriber may revoke his subscription at any time before the corporation is formed. *Hudson Real Estate Co. v. Tower*, 161 Mass. 10, 36 N. E. 680, 42 Am. St. Rep. 379 (1894).

³² Mr. Justice Strong in *Burke v. Smith*, 16 Wall. 390, 396-97 (U. S. 1892), said: "When a company is incorporated under the General Laws and the law prescribes that a certain amount of stock shall be subscribed before corporate powers shall be exercised, if subscription obtained before the organization was effected may be subsequently rendered unavailable by conditions attached to them, the substantial requirements of the law are defeated. . . . The grant of the franchise is therefore made dependent upon securing a specified amount of capital. If the subscriptions to the stock can be clogged with such conditions as to render it impossible to collect the fund which the State required

his respective subscription in order to have the charter filed as long as the minimum paid in capital is fifty percent of the aggregate authorized capital stock.³³

The first English corporate statutes required the corporation to commence business with the amount specified in the certificate of incorporation to be paid in cash.³⁴ But this rule has been relaxed, and now stock may be issued originally for property or labor as well as cash, and in the absence of fraud, no question as to the value of the quid pro quo may be raised.³⁵ But this is not to be interpreted as money to be paid in, property to be received, or services to be performed,³⁶ and the stock must not be issued in excess of the actual value of the property received or the services done.³⁷ "The board of directors of the corporation may require the subscribers to pay the amount of the capital stock respectively subscribed by them in such manner as may be required by the by-laws."³⁸ If the stockholder refuses or neglects to pay his installments, the stock will be forfeited when notice of thirty days is personally served upon him by the board of directors.³⁹ The stock-

to be provided before it would assent to the grant of corporate powers, a charter might be obtained without any available capital. . . . They, therefore, are a fraud upon the grantor of the franchise, and upon those who may become creditors of the corporation. They are also a fraud on the unconditional stockholders who subscribed to the stock in the faith that sufficient capital would be obtained to complete the projected work and who may be compelled to pay their subscription though the enterprise has failed and their whole investment has been lost. It is for these reasons that such conditions are denied any effect."

See also *Stevens v. Davenport*, 19 S. W. (2d) 445 (Tex. Civ. App. 1929).

³³ *Stringfellow v. Panhandle Packing Co.*, 213 S. W. 250 (Tex. Comm. App. 1919).

³⁴ See DWIGHT, *Capital and Capital Stock* (1907) 16 YALE L. J. 161.

³⁵ TEX. CONST. (1876) Art. XII, § VI; TEX. REV. CIV. STAT. ANNO. (Vernon, 1925) art. 1308.

³⁶ *San Antonio Irrigation Co. v. Deutschmann*, 102 Tex. 201, 105 S. W. 486 (1907); *Mitchell v. Porter*, 223 S. W. 197 (Tex. Comm. App. 1920); *Turner v. Cattleman's Trust Co. of Ft. Worth*, 215 S. W. 831 (Tex. Comm. App. 1919).

³⁷ TEX. REV. CIV. STAT. ANNO. (Vernon, 1925) art. 1353; *Donaho v. Carwile*, 214 S. W. 553 (Tex. Civ. App. 1919).

³⁸ TEX. REV. CIV. STAT. ANNO. (Vernon, 1925) art. 1335.

³⁹ TEX. REV. CIV. STAT. ANNO. (Vernon, 1925) art. 1336.

holders may be liable for the amount of their unpaid subscription under execution against the corporation.⁴⁰

These subscribers have two years from the date of filing of the charter in which to pay the unpaid portion of capital stock of the company; at the end of that time, the Secretary of State must be notified in the same manner as in the filing of the original charter.⁴¹ If this condition subsequent is not carried into effect, it is within the power of the Secretary of State to forfeit the charter of the corporation⁴² upon due notice.⁴³ If the corporation later complies with the requisite within six months after the forfeiture, the Secretary of State may reinstate its charter.⁴⁴

To further stabilize corporate existence, once the capital stock of a corporation has been fixed, no reduction of the authorized capital can be made unless the rights of creditors are protected.⁴⁵ If the company permits impairment of the capital stock, it is not permitted to transact further business until it shall make good such impairment,⁴⁶ and the Attorney General may institute quo warranto proceedings to forfeit the charter.⁴⁷

But if a company is not able to raise sufficient minimum paid-in capital to amount to fifty percent of the required capital, Article 1331 provides for the increase of capital stock by a two-thirds vote of all outstanding stockholders with voting privileges. This increase must be filed with the Secretary of State in the same

⁴⁰ TEX. REV. CIV. STAT. ANNO. (Vernon, 1925) art. 1345; see *Bank of Desota v. Reed*, 50 Tex. Civ. App. 102, 109 S. W. 256 (1908); *McCord v. Southwestern Sundries Co.* 158 S. W. 226 (Tex. Civ. App. 1913); *Bivins v. Panhandle Packing Co.*, 140 S. W. 523 (Tex. Civ. App. 1911).

⁴¹ TEX. REV. CIV. STAT. ANNO. (Vernon, 1925) art. 1338.

⁴² TEX. REV. CIV. STAT. ANNO. (Vernon, 1925) art. 1339.

⁴³ TEX. REV. CIV. STAT. ANNO. (Vernon, 1925) art. 1340.

⁴⁴ TEX. REV. CIV. STAT. ANNO. (Vernon, 1925) art. 1341.

⁴⁵ TEX. REV. CIV. STAT. ANNO. (Vernon, 1925) art. 1332: "A corporation may decrease its stock by a two-thirds vote of all its outstanding stock." Complete proof must be supplied the Secretary of State by affidavit for such decrease to become effective.

⁴⁶ TEX. REV. CIV. STAT. ANNO. (Vernon, 1925) art. 1379.

⁴⁷ TEX. REV. CIV. STAT. ANNO. (Vernon, 1925) art. 1380.

manner as the original charter.⁴⁸ This provision may be an adequate aid to some incorporators, but it has been held that such increases shall never be allowed to double the original authorized capital of the corporation.⁴⁹

DIFFICULTIES IN THE OPERATION OF ARTICLE 1308

The majority of the corporations in Texas are founded on one of two different bases. First, where the non-corporate business is already organized and profitable, the owners, desiring the advantage of limited liability, decide to incorporate their existing business. The minimum capital stock requirement is of no consequence. Second, where one person has an idea that he believes in but is without capital, he seeks financial backing to develop his idea. He may find a few people who believe as he does that the resulting business will be profitable, or he may have to sell stock to a great number of people to raise sufficient funds. A minimum amount of the authorized capital stock may be difficult to obtain.

An objection which has been voiced to this requirement is that "such provision invites an evasion of the spirit by compliance with the letter of the requirement. If persons are to incorporate their existing business, it is more logical and reasonable for them to be able to transfer the assets of the old business to the new corporation after it has been formed."⁵⁰ In addition, since there is no corporate organization to which the fund can be paid, it must be transferred to someone for the benefit of the future corporation. It therefore would seem more logical and more workable to make payment into the corporation treasury of a certain amount of capital a condition precedent to the right to commence business and incur debts rather than a condition precedent to the right to incorporate.

Since the validity and legality of a corporation can only be

⁴⁸ TEX. REV. CIV. STAT. ANNO. (Vernon, 1925) art. 1330. Increase of capital stock by amendment alone is void. *Kampman v. Tarver*, 87 Tex. 491, 29 S. W. 768 (1895).

⁴⁹ TEX. REV. CIV. STAT. ANNO. (Vernon, 1925) art. 1332.

⁵⁰ UNIFORM BUSINESS CORPORATIONS ACT, §8, Commissioners' note.

questioned by the State in quo warranto proceedings for that purpose, the corporation is not void if it does not comply with the minimum paid-in capital requirement.⁵¹ Therefore, one who becomes a creditor of the corporation after the certificate of incorporation has been issued would not be able to attack corporate existence and would find himself bound to a corporation which had no assets. It may be suggested that the liability of directors and stockholders who are responsible for a violation of the prerequisite should not be conditioned upon the creditor's ability to prove the deception.

The strictness in the technicalities of organization often tends to hinder the substantial increase in the number of companies incorporated in this state. In a recent bulletin published by the Corporation Service Company,⁵² statistics show that out of the 822 corporations listed on the New York Stock Exchange, approximately 88 percent were organized in states that did not require minimum paid-in capital as a condition precedent to incorporation. Only five of these companies were incorporated in Texas.

It would seem that substantial revenue to a state is derived from Taxation of corporations. Thus partially relieving the strictness of the prerequisites to incorporation would tend to encourage more companies to incorporate in this state.

Also, modern practice in the majority of the cases is first to organize the corporation, and then to sell the stock. The latter procedure is facilitated by the fact that investment bankers quite commonly underwrite the sale of stock or actually take over the

⁵¹ See note 20 *supra*.

⁵² Statistics were reproduced from STATE GOVERNMENT, official magazine of the Council of State Governments: Delaware (to commence business) 235 corporations; New York (no provision) 146; New Jersey (to commence business) 97; Pennsylvania (to commence business) 45; Ohio (to commence business) 29; Virginia (no provision) 32; Maryland (no provision) 31; Michigan (to commence business) 29; Illinois (to commence business) 26; Massachusetts (to commence business) 20; Maine (no provision) 19; Missouri (to commence business) 9; California (no provision) 9; Wisconsin (to incorporate) 9; Connecticut (to commence business) 8; Indiana (to commence business) 7; Texas (to incorporate) 5; West Virginia (to commence business) 5; other states—33; foreign—22. Of course, other factors also govern the state in which companies incorporate.

entire stock and run the risk of selling it. The subscription list is still used, however, prior to incorporation in certain instances. The proposed corporation may be too small or too speculative to attract the attention of the investment bankers.⁵³ As the subscription list is required in Texas, promoters usually handle the sale of stock. They must have a prospectus of the proposed corporation giving all pertinent details of the business, how it is to be run, and the scope. The Texas Securities Act⁵⁴ provides for the regulation of these promoters. They must obtain permission from the Secretary of State before they attempt to sell any stocks, bonds, or other securities. The promoters must register; they can be enjoined by the Attorney General if found to be employing "any device, scheme or artifice to defraud or obtain money or property by means of false pretenses."

THE STATUTORY FORMULA OF THE MAJORITY STATES: PAID-IN CAPITAL AS A CONDITION OF DOING BUSINESS

Some states have favored corporate and capitalistic organization in general, while other jurisdictions have given more attention to the protection of the stockholders, creditors, and public in general. Under the existing statutes, there is a division between the practices of: a) requiring a certain fund to be paid in before incorporation, b) having no requirement that a minimum fund be paid in at any time, and c) requiring a certain fund to be paid in before the corporation may commence business. Only four states require that the payment of a certain fund is a prerequisite to corporate existence—the percentages to be paid in ranging from ten percent required in Utah to the fifty percent

⁵³ See DONALDSON, *BUSINESS ORGANIZATION AND PROCEDURE* (1938) 95.

⁵⁴ TEX. REV. CIV. STAT. ANNO. (Vernon, 1925) art. 600a; TEX. PEN. CODE (Vernon, 1925), art. 1083a. When the stock is sold to a non-resident, the Federal Securities Act of 1933 governs. 48 STAT. 74 (1933), 15 U. S. C. A. § 77a-77aa (1940); see Note (1933) 19 A. B. A. J. 643.

required in Texas.⁵⁵ Nineteen states require that no minimum amount shall be paid in at any time.⁵⁶ Twenty-six states require the payment of a certain fund before the corporation can commence business—the nominal usually ranging from three hundred dollars to one thousand dollars.⁵⁷ When the latter is the requirement, several states require that in order to commence business, the directors must sign an affidavit and deliver it to the Secretary of State declaring that the minimum capital has been

⁵⁵ Alabama, ALA. CODE (1940) tit. 10, art. 1, §§ 2, 4 (twenty percent); South Carolina, S. C. CODE OF LAWS (1942) § 7730 (twenty percent); Texas, TEX. REV. CIV. STAT. ANNO. (Vernon, 1925) art. 1308; Utah, UTAH CODE ANNO. (1943) § 18-2, 6 (ten percent paid in).

⁵⁶ Arizona, ARIZ. CODE (1939); California, CALIF. CIV. CODE (Deering, 1940); Colorado, COLO. STAT. ANNO. (1935); Georgia, GEO. CODE (1933); Idaho, IDAHO CODE (1932); Iowa, IOWA STAT. (1946); Maine, ME. REV. STAT. (1944); Maryland, MD. CODE (Flack, 1939); Massachusetts, MASS. GEN. LAWS (1932); Montana, MONT. REV. CODE (Anderson and McFarland, 1935); Nevada, NEV. COMP. LAWS (Hillyer, 1929); New Hampshire, N. H. REV. LAWS (1942); New York, N. Y. CON. LAWS (McKinney, 1946); North Dakota, N. D. REV. CODE (1943); Oklahoma, OKLA. STAT. ANNO. (1937); Rhode Island, R. I. GEN. LAWS (1938); Virginia, VA. CODE (Michie, 1942); Wyoming, WYO. REV. STAT. (1931). Two states have no requirement concerning par stock but require a minimum paid-in capital of \$500 and \$1,000, respectively, for no par stock: South Dakota, S. D. CODE (1939) § 11.0401; Oregon, ORE. COMP. LAWS ANNO. (1940) § 77-228.

⁵⁷ Arkansas, ARK. STAT. (Pope, 1937) § 2129-g (\$300); Alabama, ALA. CODE (1940) tit. 10, art. 1, §§ 2, 4 (25 percent but not less than \$1,000); Connecticut, CONN. GEN. REV. STAT. (1930) § 3396 (\$1,000); Delaware, DEL. REV. CODE (1935) § 2037.5 (\$1,000); Florida, FLA. STAT. (1941) § 612.23-4 (\$500); Illinois, ILL. REV. STAT. (1945) c. 32, 157.47-i (\$1,000); Indiana, IND. STAT. (Burns, 1933) § 25-216-8 (\$500); Kansas, KAN. GEN. STAT. (Supp. 1945) § 17-2802 (\$1,000); Kentucky, KY. REV. STAT. (1947) 271.085 (\$1,000); Louisiana, LA. GEN. STAT. (Dart, 1939) art. 1088 (\$1,000); Michigan, MICH. COMP. LAWS, Cum. Supp. (Mason, 1940) § 10135.4 (\$1,000); Minnesota, MINN. STAT. (1945) § 301.04-6 (\$1,000); Mississippi, MISS. CODE (1942) § 5310 (commence business as soon as the amount specified in the charter has been paid-in); Missouri, MO. REV. STAT. SUPP. (1944) c. 33, § 50' (\$500); Nebraska, NEB. REV. STAT. (1943) c. 21-105 (commence business as soon as the amount specified in the charter has been paid in); New Jersey, N. J. REV. STAT. (1937) § 14:2-3 (\$1,000); New Mexico, N. M. STAT. ANN. (1941) § 54-208.4 (\$1,000); North Carolina, N. C. GEN. STAT. (1943) § 55-2.4 (commence business as soon as the amount specified in the charter has been paid in); Ohio, OHIO CODE ANN. (Throckmorton, 1940) § 8623.4 (\$500); Oregon, ORE. COMP. LAWS ANNO. (1940) § 77-228 (none for par stock, \$1,000 to commence business for no par stock); Pennsylvania, PENN. STAT. (Purdon, 1936) § 2853-204, 8 (\$500); South Dakota, S. D. CODE (1939) § 11.0401 (none for par stock, \$500 to commence business with no par stock); Tennessee, TENN. CODE (Williams, 1934) § 3714, 5 (\$1,000); Vermont, VT. PUB. LAWS (1933) § 5832 (\$500); Washington, WASH. CODE (Pierce, 1939) art. 3803 (\$500); West Virginia, W. VA. CODE (1931) c. 31 art. 1, § 6 (\$1,000); Wisconsin, WIS. STAT. (1945) art. 180.06 (one-fifth of the capital stock must be paid in to commence business).

paid-in, before they can commence business.⁵⁸ Other states hold such to be a de facto corporation and if the party injured transacted his business with them as a corporation, the directors and stockholders cannot be held liable as partners.⁵⁹ In many jurisdictions this has been remedied by statute making them liable for commencing business before the capital stock has been paid in.⁶⁰ The Business Corporations Act states that "if a corporation has transacted any business in violation of this section, the officers who participated therein and the directors, except those who dissented therefrom and caused their dissent to be filed at the time in the registered office of the corporation, or who, being absent, so filed their dissent upon learning of the action shall be severally liable for the debts or liabilities of the corporation arising therefrom."⁶¹ From this statutory analysis, it seems that the majority of the states have deemed it more adequate to require merely minimum paid-in capital as a requirement to begin business and to incur debts.

When the committee on the Uniform Laws drafted the Business Corporations Act, they felt that corporate success would be facilitated more easily by requiring a minimum amount of paid-in capital to commence business. These provisions state that the corporation must have a certain amount of capital then under liability for all debts incurred.⁶² Even the National Banking Act, requiring the highest degree of security, does not require any portion of its capital to be paid in before incorporation, but it does require that a proportion of the capital stock shall be paid in before the bank may receive its certificate authorizing the commencement of business from the Comptroller.⁶³

⁵⁸ MO. REV. STAT. (Supp. 1944) c. 33, § 55; VT. PUB. LAWS (1933) art. 5832.

⁵⁹ *Moe v. Harris*, 142 Minn. 442, 172 N. W. 494 (1919).

⁶⁰ *American Radiator Co. v. Kinnear*, 56 Wash. 210, 105 Pac. 630 (1909); Note (1927) 50 A. L. R. 1030; Note (1912) 35 L. R. A. (N. S.) 453.

⁶¹ UNIFORM BUSINESS CORPORATIONS ACT, § 8-2.

⁶² UNIFORM BUSINESS CORPORATIONS ACT, §§ 7, 8.

⁶³ 13 STAT. 103 (1864), 12 U. S. C. A. § 53 (1940). At least fifty percent of the capital stock of every association shall be paid in before the Comptroller will authorize them to commence business.

If the capital of a corporation is fixed by its charter at a certain sum, this would *prima facie* indicate that the company would have no right to commence business until the whole amount of capital prescribed in the charter has been obtained, with the majority of the capital subscribed as a condition precedent to the right of carrying on corporate business. Until that amount has been subscribed and paid in, the right of the company to begin to carry on business remains inchoate, and the agents of the company have no authority to perform any acts except such as are necessary to perfect its organization, and prepare it for the prosecution of its regular business after the capital agreed upon has been obtained.

On the other hand, unprecedented liberality in so far as the capital requirements are concerned tends to place the corporate existence on a too speculative basis. The theory upon which the charter is issued is based on the assumption that the capital stock which the corporation holds itself out as having will be paid in cash, property, or services rendered that are the bona fide or actual value that the corporation has bestowed upon it. The subscriber must be bound on his subscription contract. There must be a just substitute for the limited liability that incorporation furnishes. The creditors should not be left in the dark as to the real financial status of the organization when they contemplate business with a newly formed corporation—and there are no adequate provisions for the payment in value of the capital stock.⁶⁴ In these liberal states with every technique of power being developed, no endeavor of any sort is being made to work out the limitations which prevent abuse.

The trend of incorporation laws during the past several decades has been toward a more liberal law. New Jersey and Delaware in an effort to swell the state treasury with funds were early to liberalize their corporation codes. Other states, in an effort

⁶⁴ The evils of too much leniency are clearly indicated in *Monk v. Barnet*, 113 Va. 635, 75 S. E. 185 (1912); Note (1921) 7 VA. L. REV. 159.

to encourage domestic incorporation to attract some of the foreign incorporation business have rapidly followed suit. One example of this can be seen in the minimum paid-in capital requirements. While this is highly desirable economically speaking, there must be a balance remaining to safeguard the interests of the general public, creditors, and the stockholders of all corporations.

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