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## The Uniform Business Corporation Act

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## THE UNIFORM BUSINESS CORPORATION ACT

**T**HE formulation of a Uniform Business Corporation Act was first considered in 1909 by the National Conference of Commissioners on Uniform State Laws, and the subject was presented at numerous subsequent meetings of the conference. The Act was tentatively adopted in 1927 and finally approved by the Conference in 1928. The result of painstaking section-by-section consideration of the most practical developments, statutes, and policies governing corporations throughout the English-speaking world, the Act attempts to harmonize the law with reference to a number of important and frequently litigated fields of corporate endeavor. Although the Act is worthy of detailed consideration, it is the purpose of this note simply to indicate in somewhat summary fashion certain desirable features of the Act and equally its less satisfactory provisions when it is compared with existing Texas corporation statutes.

### QUALIFICATIONS OF INCORPORATORS

The provisions under Section 2 of the Act relating to qualifications of incorporators do not require that any of the incorporators be residents of the state where incorporation is consummated. This attempt to eliminate dissimilarity between domestic and foreign corporations in this respect merely recognizes the practical result which follows in many states requiring residence therein of at least one or two incorporators, that a resident is secured only for the purpose of fulfilling the statute with no intention of becoming or continuing a shareholder.<sup>1</sup> Such dispensing with the requirement of residence was undoubtedly influenced by the better view of the decisions that the incorporators' lack of qualification does not pre-

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<sup>1</sup> TEX. REV. CIV. STAT. (Vernor, 1925) art. 1305.

vent the formation of a de facto corporation.<sup>2</sup> While there is no requirement in Texas that the incorporators must own stock, Article 1305<sup>3</sup> does require the charter to be "subscribed by three or more persons two of whom must be citizens of this state."

#### CORPORATE PURPOSES

As a general rule, most states allow a corporation to be created to carry on any lawful business with certain statutory exceptions. By Article 1302,<sup>4</sup> however, Texas has enumerated more than a hundred limited purposes for which a corporation may be formed. This inversion has caused some difficulty in application, particularly with respect to corporations that have been formed for a combination of purposes. It has been the policy to limit the right of incorporation to specific purposes authorized by statute and to disallow additional purposes or combinations unless so specifically enumerated. However, validity of purpose can generally be questioned only by the state; and in the case of a corporation created in part for purposes beyond those recognized by statute, there is authority for the proposition that the excess should be treated as surplusage.<sup>5</sup>

#### EFFECT OF SHARE SUBSCRIPTION

Cases are at present in conflict as to the effect of a subscription to shares in a corporation to be formed. The weight of authority, however, seems to be that a subscription is in effect a continuing offer by the subscribers.<sup>6</sup> Another view is that the subscribers are in privity of contract with each other. In either case, the subscriber may generally withdraw his subscription before an acceptance by

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<sup>2</sup> *American Salt Co. v. Heidenheimer*, 80 Tex. 344, 15 S. W. 1038 (1891), 26 Am. St. Rep. 743.

<sup>3</sup> Art. 1305, *supra*.

<sup>4</sup> TEX. REV. CIV. STAT. (Vernon, 1925) art. 1302.

<sup>5</sup> *Galveston Land and Improvement Co. v. Perkins*, 26 S. W. 256 (Tex. Civ. App. 1894); *Staacke v. Routledge*, 175 S. W. 444 (Tex. Civ. App. 1915).

<sup>6</sup> See 2 FLETCHER, CYCLOPEDIA OF CORPORATIONS, § 523; 1 COOK, CORPORATIONS, § 167.

the corporation. Section 6 of the Act provides that subscriptions shall be irrevocable for a period of one year from the date of signing, unless revocation is justified under equity or contract principles of rescission for fraud, duress or undue influence in procurement. This recognizes the strong public interest in protecting and maintaining resources in the form of enforceable subscriptions to insure the financial stability of the newly forming corporation. Accordingly, Sections 5 and 6 of the Act place the incorporators and the subscribers in the same position, making subscriptions irrevocable; upon incorporation, both automatically become shareholders whether the stock has been paid for or not.

#### REQUIREMENT OF PAID-IN CAPITAL

Under existing statutes, there is a division as to the amount of capital to be paid in upon incorporation. Twelve states, including Texas,<sup>7</sup> require a certain fund to be paid in before incorporation; nineteen jurisdictions require a certain fund to be paid in before the doing of business; and twenty-two jurisdictions have no requirement that a minimum amount be paid in at any time. Section 8 of the Act requires that the corporation should not begin business until the capital has been paid in as stated in the Articles of Incorporation. The Commissioners' Note to Section 8 of the Act advances several arguments against paid-in capital before incorporation and in favor of paid-in capital before commencing business, stating that the minimum requirement for funds to be paid in before incorporation—generally from \$500 to \$1000 under most statutes—invites a minimum compliance with the statute solely for the purpose of fulfilling the statutory prerequisites and with an intention of undertaking the real financing after incorporation. It is also advanced that since there is no corporation to receive payment, the fund must be transferred to someone for the benefit of the future corporation, *e.g.*, to a trust company or to the directors named in the Articles or to the treasurer.

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<sup>7</sup> TEX. REV. CIV. STAT. (Vernon, 1925) art. 1308.

Moreover, the consequence of a non-compliance with the requirement of paid-in capital before incorporation is noted, reference being made to the Illinois case of *Foster v. Hip Lung & Co.*,<sup>8</sup> in which it was held that non-compliance with the statute did not prevent the formation of a de facto corporation; attention is directed to the suggestion of the case that as a result one who became a creditor after the certificates of incorporation had been issued would not be able to attack the corporate existence and might find himself bound to a corporation which had no real assets.

However, these observations are not thoroughly persuasive that Sections 7 and 8 of the Act, requiring that funds be paid in prior to doing business, should be adopted, especially since those statutes requiring only \$500 to \$1000 to be paid in before incorporation seem to indicate that the legislatures in those states do not give much importance to the amount to be paid in either before or immediately after incorporation. It is not probable that those jurisdictions which require only a small amount to be paid in before incorporation would, after adoption of the Act, require a substantially larger sum, under Section 7 of the Act, to be paid in before beginning business. Section 7 of the Act leaves the amount to be paid in before commencing business optional. The Louisiana Uniform Act<sup>9</sup> provides for a minimum paid-in capital of \$1000. The Washington Uniform Act<sup>10</sup> provides for a minimum of \$500.

Article 1308 of the Texas general incorporation statute, does indicate, however, that emphasis is placed upon the amount to be paid in before incorporation, inasmuch as it requires that capital stock must be 100 per cent subscribed and 50 per cent paid in. Since the controlling purpose of requiring paid-in capital before incorporation or doing business is the protection of creditors, the Texas statute would seem to adopt the sounder rule,

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<sup>8</sup> *Foster v. Hip Lung & Co.*, 243 Ill. 163, 90 N. E. 375 (1909).

<sup>9</sup> DART'S GEN. STAT. (1932) § 1088.

<sup>10</sup> REM. REV. STAT. § 3803-7.

for paid-in capital of \$1000 might afford little security to creditors of a large newly-formed corporation. Nor is it a serious objection to the statutes requiring a certain amount of paid-in capital before incorporation that there being no corporation in existence to receive payment the fund must be transferred to an agency for the future corporation. Payment to the treasurer of the incorporators or to a body selected by them, in the absence of statutory direction to whom payment should be made, is generally done with facility.

### DE FACTO CORPORATIONS

The majority of American jurisdictions early recognized the rule that de facto corporations have a legal existence. This rule was later adopted in England by Section 17 of the Consolidation Act of 1918 and in Canada by virtue of Sections 4 and 111 of the Dominion Companies Act. The general rule recognizes that where the object is legal and there has been a good faith attempt to incorporate and a substantial compliance with the spirit of the statutory prerequisites, a de facto corporation is formed, and the corporate existence is not subject to collateral attack at the instance of third parties or a corporation in a suit against it. Such action can be brought by the state only,<sup>11</sup> and in a direct proceeding.<sup>12</sup>

There seems to be conflict as to whether there may be an estoppel to deny the legal incorporation of an association that is not a de facto corporation. One view is that there may be an estoppel even in such event.<sup>13</sup> A contrary view has been followed in other jurisdictions. There have been intimations that Texas follows the latter

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<sup>11</sup> *Oriental v. Barclay*, 16 C. A. 193, 41 S. W. 117 (1897); *Conley v. Daughters of Republic of Texas*, 151 S. W. 877 (Tex. Civ. App. 1912).

<sup>12</sup> *Commercial Standard Ins. Co. v. Nelson Mortgage Co.*, 138 S. W. (2d) 169 (Tex. Civ. App. 1940).

<sup>13</sup> *Rogers v. Toccoa Power Co.*, 161 Ga. 524, 131 S. E. 517 (1926); *Close v. Glenwood Cemetery*, 107 U. S. 466 (1882).

doctrine,<sup>14</sup> but Article 1317<sup>15</sup> and subsequent cases indicate a contrary disposition.<sup>16</sup>

Section 9 of the Act is an attempt to create uniformity in the de facto problem by making the certificate of incorporation conclusive evidence of the fact that the corporation is incorporated, leaving the exclusive power of collateral attack to the state, and then only where the corporation is invalid or illegal under the Act, or where there is no substantial compliance with the mandatory provisions that are prerequisite to incorporation. By virtue of Texas Article 1317 and the decisions thereunder, there would be relatively little change wrought in the Texas law, as regards de facto corporations, by adoption of Section 9 of the Act.

#### ULTRA VIRES ACTS

The practice of filing the Articles of Incorporation with a state office has been assigned as a reason for precluding recovery by a party upon an ultra vires contract with a corporation, upon the theory that parties dealing with a corporation are charged with constructive notice of the limitations of the corporation.<sup>17</sup> In a Virginia case<sup>18</sup> the court propounded a contrary rule. The court allowed the plaintiff to recover on a note issued ultra vires, holding "that ultra vires is not a good defense where the recognition of it will not advance justice and fair dealing." Section 10 of the Act makes a noteworthy attempt to dispense with a portion of the confusion attributed to the problem of ultra vires in this respect. It provides that the filing or recording of the Articles of Incorporation and other ancillary and required papers is to be performed

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<sup>14</sup> *Empire Mills v. Alston Grocery Co.*, 15 S. W. 200 (1891); *Payne v. Bracken*, 90 S. W. (2d) 607, *aff'd*, in 115 S. W. (2d) 903 (1938).

<sup>15</sup> TEX. REV. CIV. STAT. (Vernon, 1925) art. 1317.

<sup>16</sup> *Maurice v. Schwind*, 101 S. W. (2d) 1085 (Tex. Civ. App. 1937); see 1 HILDEBRAND, TEXAS CORPORATIONS (1942) c. 5.

<sup>17</sup> *Richardson v. Bermuda Land & Live Stock Co.*, 210 S. W. 746 (Tex. Civ. App. 1919).

<sup>18</sup> *City Coal & Ice Co., Inc. v. Union Trust Co.*, 125 S. E. 697 (1924), noted in 10 CORN. L. Q. 498.

only for the purpose of affording a public record to persons interested therein but not to operate as constructive notice of the contents. In dispensing with constructive notice notions, the section does not purport to alter the more applicable doctrines of the law of agency which require third parties to ascertain, within reasonable limits, the authority of the agent with whom they are dealing. Certainly corporations should be protected from third parties who have been palpably negligent in dealing with the corporate representatives; but to allow the corporate body further insulation in the form of constructive notice involves failure to recognize the underlying desirability of a policy that fosters in the public a feeling of security when dealing with corporate agents acting within the apparent scope of the business.

In 1924 the Conference made its first attempt to deal with the ultra vires problem in the Ninth Draft of the Act. Prior to this time only one state legislature, that of Vermont, had made a significant effort to clarify the problem.<sup>19</sup> The existing state statutes in American jurisdictions,<sup>20</sup> and the many decisions thereunder, have produced a seeming inextricable maze of confusion of doctrines regarding the distinctions between the authority of a corporation to act ultra vires and the capacity to act ultra vires.<sup>21</sup> By Section 11 of the Act, corporations shall have the capacity to act possessed by natural persons, but shall have authority to perform only such acts as are necessary to accomplish its purposes, and which are not illegal. In theory, this is an attempt not to unsettle the law relating to ultra vires transactions, but to reinforce the majority of existing decisions and lend a uniform yardstick to the courts. However, in the absence of additional statutory enactments, it is to be doubted that the language of that section is specific enough practically to effect the uniformity of decision that is sought.

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<sup>19</sup> VT. GEN. LAWS (1917) §§ 4919, 4923.

<sup>20</sup> TEX. REV. CIV. STAT. (Vernon, 1925) art. 1348, *et seq.*

<sup>21</sup> See 1 HILDEBRAND, TEXAS CORPORATIONS (1942) c. 4; Stevens, *A Proposal as to the Codification and Restatement of the Ultra Vires Doctrine* (1927) 36 YALE L. JOUR. 297.

### HOLDING STOCK IN OTHER CORPORATIONS

Unless ancillary to the business, and in the absence of an express or implied authorization, most courts hold that it is ultra vires for a corporation to subscribe and hold shares in another corporation; the objections generally are that if the corporations are different in nature, the share-holding corporation is launched on a business not authorized by its charter,<sup>22</sup> and if the corporations are similar there is a possible violation of anti-trust laws. However, the power to hold stock in another corporation is often implied on the reasoning that the effectuating of the corporate purpose is consistent with the acquisition of the stock of another corporation. In *Texas Utilities Company v. Story*,<sup>23</sup> the court said that "The prevailing doctrine is that a corporation has no power either to subscribe for or purchase shares of stock in another corporation, unless such power is expressly conferred upon it by its charter or other statute, or unless the circumstances are such that the transaction is a necessary or reasonable means of carrying out or accomplishing the objects for which it was created. . . ." Section 12 of the Act endorses the use of subsidiary corporations as agencies to carry on the general corporate business, but does not purport to permit the corporation to engage indirectly in a dissimilar business through the purchase of stock. It provides that a corporation "to accomplish its purpose as stated in the Articles of Incorporation, may guarantee, acquire, hold, mortgage, pledge, or dispose of the shares, bonds, securities, and other evidences of indebtedness of any domestic or foreign corporation." This section is more or less declaratory of present Texas law with the exception that, by virtue of Article 1349,<sup>24</sup> a corporation in Texas may contribute to, hold, or subscribe to, stock in another corporation on the basis that the subscription is in furtherance of

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<sup>22</sup> *Adams National Bank v. Adams Co.*, 298 S. W. 309 (Tex. Civ. App. 1927).

<sup>23</sup> *Texas Utilities Co. v. Story*, 85 S. W. (2d) 809 (Tex. Civ. App. 1935).

<sup>24</sup> *TEX. REV. CIV. STAT.* (Vernon, 1925) art. 1349.

a civic enterprise, without regard to whether or not it is in furtherance of the corporate object.<sup>25</sup>

#### CONSIDERATION FOR STOCK

Under Section 15 of the Act, no allotment of shares can be made except pursuant to subscriptions or declaration of stock dividends; and such subscriptions may be made payable with cash, other property, or necessary services actually rendered to the corporation. This provision is in substantial accord with Texas Article 1308. The value of the consideration so received in payment for shares is regulated by Section 15 and Section 17 of the Act.

The Texas Constitution provides that no corporation shall issue stock or bonds except for money paid, labor done, or property actually received.<sup>26</sup> Before the certificate of stock can be issued and delivered to the stockholder, therefore, the stock must have been paid for.<sup>27</sup> Section 16 of the Act provides that no certificate shall issue until the shares represented thereby are fully paid, and if a note is given as payment for shares, such shall not be full payment until the note is paid. In general, the section is consonant with the majority of Texas decisions and in accord with the better view that to allow stock to be issued when not paid for, represents an outstanding liability as stock and is misleading to third parties who should be able to assume that the corporation has received value.

Under Texas Article 1330,<sup>28</sup> the board of directors or other managing officers of the corporation may increase its authorized capital stock by stockholders meeting and compliance with Article 1308 and/or Article 1538(d). Under these statutes, if property is received other than cash in payment for stock, then the affidavit filed with the Secretary of State must recite the cash value of the

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<sup>25</sup> *A. J. Anderson Co. v. Citizens Hotel Co.*, 8 S. W. (2d) 702 (Tex. Civ. App. 1928).

<sup>26</sup> TEX. CONST. (1876) art. XII, § 6.

<sup>27</sup> *Zapp v. Spreckles*, 204 S. W. 786 (Tex. Civ. App. 1918).

<sup>28</sup> TEX. REV. CIV. STAT. (Vernon, 1925) art. 1330.

property so received, its location, price, and the name of the grantor.

In this connection, Sections 17 through 20 of the Uniform Act constitute a significant step in the right direction. Section 17 provides that consideration for the payment of stock, other than cash, shall be taken at a fair valuation. Under existing statutes, this valuation is set by either the articles, shareholders, or the board of directors acting with authority from the shareholders. This section makes such valuations of the incorporators, shareholders or directors conclusive, and likewise conclusive the valuation placed by the directors upon corporate assets in estimating surplus to be transferred to capital as payment for shares to be allotted as dividends.

Under Texas decisions, in the absence of fraud, a stockholder is not liable for an unpaid balance due on stock because later it is ascertained that property accepted in payment was taken at more than its true value.<sup>29</sup> However, it is to be supposed that Section 20 of the Act modifies the "conclusiveness" of the valuation given to property other than cash in Section 17.

Section 18 of the Act provides that within 90 days after an allotment of shares, a report must be filed with the office of the clerk of the county in which the corporation has its registered office, showing (a) the total number of shares allotted, the number of no par shares, and the number of par value shares, (b) an accurate, detailed description of the consideration received or to be received for the shares so allotted, (c) a statement of the valuation placed by the incorporators, shareholders, or directors, as the case may be, upon consideration received other than cash, and, in the case of shares allotted as a stock dividend, the amount of surplus transferred to capital in respect of such dividend, and any part created by revaluation of assets and, if so, the value of the assets on the books before and after revaluation. Failure to comply with the section carries a substantial penalty. The purpose

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<sup>29</sup> *Dysart v. Fleming*, 140 S. W. (2d) 350 (Tex. Civ. App. 1940).

of this provision is to provide a uniform and adequate safeguard to the creditor or investor to enable him to determine financial status.

Section 19 provides that shares allotted in violation of the provisions of the Act shall not for that reason alone be invalid. Under Section 20 the subscriber is limited in liability to the extent of his subscription and, if a bona fide holder without notice of non-payment in full, he is exempt from liability for the balance of the subscription. A shareholder is limited in liability for the debts of the corporation (with optional provision for statutory exceptions).

#### LIABILITY OF PARTIES

Section 20 is declaratory of the existing Texas law as regards liability of shareholders, incorporators, directors, and officers and is not in derogation of common-law or equity principles concerning liability of such parties when engaged in fraudulent corporate practices.

#### TRANSFER OF STOCK

Since Texas has adopted the Uniform Stock Transfer Act, the subject matter dealt with in Section 21 of the Uniform Business Corporation Act, dealing with stock transfer, would necessarily and conveniently be controlled by that Act.<sup>30</sup> Under Section 15 of the Uniform Stock Transfer Act, a corporation cannot have a lien on shares represented by a certificate or place a restriction upon free transfer of such shares unless the certificate embodies such stipulations. By Section 16 of the Uniform Act, a certificate cannot be issued until shares are fully paid for, it being contemplated, however, that shares might be sold on the installment basis, and that a party might be a shareholder when he had not paid for his shares fully though he would not possess a certificate.

Section 22 of the Act gives the corporation a lien on such unpaid shares for the indebtedness, and thereby obviates the

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<sup>30</sup> TEX. REV. CIV. STAT. (Vernon, 1925) art. 1358-1 *et seq.*

necessity of placing a restriction or lien upon the certificate, the effect of which generally is only to impair the transferability of the certificate.

#### DECLARATION OF DIVIDENDS

Most courts agree upon the general proposition that a corporation may not declare dividends either in the form of cash or additional shares except from the actual earnings of the company or the surplus. Under Section 24, a dividend in cash or property cannot be paid from surplus that is derived from an appreciation of fixed assets upon revaluation, but a stock dividend can be so paid. In Texas, Article 1329<sup>31</sup> provides that dividends may be declared "of the profits from the business of the corporation." It is evident then, that Texas corporations should declare dividends from the surplus earnings or profits, and not out of appreciation in value of assets, unless those assets are converted into cash. Nor would it be proper to make payment in the form of stock dividends in view of the wording of the Texas Constitution that "no corporation shall issue stock or bonds except for money paid, labor done, or property *actually* received. . . ."<sup>32</sup>

Where dividends are wrongfully paid or corporate assets are wrongfully returned, Section 25 of the Act makes the directors who have been negligent or who have acted in bad faith liable to the extent of the misappropriation, and the shareholders individually liable to the corporation in event of a wrongful dividend for the amount of such payment where the directors cannot be held.

Texas Article 1345<sup>33</sup> limits stockholders' liability to the amount of unpaid stock; and Article 1347<sup>34</sup> provides that directors who knowingly pay dividends when the corporation is insolvent, or which would render it insolvent, are jointly and severally liable for all debts to the extent of such dividends.

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<sup>31</sup> TEX. REV. CIV. STAT. (Vernon, 1925) art. 1329.

<sup>32</sup> *Houston Cemetery Co. v. Drew*, 13 Tex. Civ. App. 536, 36 S. W. 802 (1896); TEX. REV. CIV. STAT. (Vernon, 1925) art. 1353.

<sup>33</sup> TEX. REV. CIV. STAT. (Vernon, 1925) art. 1345.

<sup>34</sup> TEX. REV. CIV. STAT. (Vernon, 1925) art. 1347.

Authorities are in conflict as to whether the amount of a wrongfully paid dividend may be secured from the bona fide stockholder where the corporation is solvent. Under Section 25 of the Uniform Act, solvency or insolvency of the corporation at the time of dividend payment is immaterial, and apparently it announces the better view, since the shareholder is a mere volunteer and his rights should not be superior to the interests of the creditors and the financial stability of the corporation as a whole. The same reasoning should apply to permit directors to be held, whether their act is consummated during insolvency or solvency, as the ultimate liability of either the directors or stockholders strengthens the corporate structure and affords the creditor a reasonable assurance of integrity.

#### VOTING RIGHTS

Generally, every stockholder has the right to vote at stockholders' meetings, unless prohibited from doing so by charter provision, by-law, or agreement enacted prior to his acquisition of the shares. Under Section 28 of the Act, the stockholder of record is entitled to one vote per share standing in his name on the books, unless otherwise provided in the Articles of Incorporation. In Texas there is no general statute giving the shareholders of a private corporation the right to a vote per share, to vote by proxy, or of cumulative voting; but shareholders in railway and insurance companies are, by statute, given a vote per share, the right to proxy votes and, in the case of railway companies, cumulative voting power.<sup>35</sup> However, as a general rule in most jurisdictions and in Texas, each share is entitled to one vote, either by statute, charter, by-law, or custom.

Under sub-Section II, where voting privileges are given to a limited class of shareholders by the Articles of Incorporation they may be liable to the corporation for the benefit of non-voting shareholders for breach of duty. This provision is doubtless aimed

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<sup>35</sup> TEX. REV. CIV. STAT. (Vernon, 1925) arts. 4718, 4803, 6289, 6293.

at the possible abuses of "management stock." Sub-Sections III and IV provide for cumulative voting for directors and proxy voting.

By the general rule, the pledgor of stock may vote it until the pledgee acquires title or transfers the shares on the corporation transfer books. In a few states statutes define the rights as between the pledgor and pledgee in matters of voting. Texas has no such statute, but by virtue of the Uniform Stock Transfer Act the registered owner may vote his stock. Nor can the corporation vote its own stock by the better view. Sub-Section V provides that the pledgor vote his shares until transferred on the books to the pledgee, and that persons holding shares as trustees or fiduciaries may vote in person or by proxy. Under this sub-Section, where shares are held without restriction by fiduciaries jointly, the majority controls the votes, and in event of equal division, a proper court may, upon petition, appoint another party to assist the fiduciaries in breaking the deadlock. There is conflict between the text writers over the question of whether voting of shares held jointly requires the unanimous consent of the holders or whether the majority should control.<sup>36</sup> However, the Act again announces probably the better view since it prevents arbitrary action on the part of one or more fiduciaries to the possible detriment of the equitable owner of the shares. Clearly, not voting may be more injurious than ill-advised voting.

The authorities are not in agreement as to the validity of voting trusts. A minority of jurisdictions have held such agreements illegal in that they attempt to separate the power to vote from the beneficial ownership of the shares and deprive the shareholder of the free exercise of his judgment. However, the majority of the courts sustain such agreements or trusts where the object to be accomplished is not illegal or against public policy and is established with a view to furthering the interests of the stock-

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<sup>36</sup> See STEPHENS, CORPORATIONS, p. 461; FLETCHER, CYCLOPEDIA OF CORPORATIONS, § 2038; BALLANTINE, PRIVATE CORPORATIONS, pp. 571-572.

holders. However such pools should be condemned when fraudulent or tending towards monopoly, when they create an unfair advantage over minority stockholders,<sup>37</sup> or when they attempt to evade a statute. Section 29 of the Act allows shareholders to transfer their shares to a person or corporation as trustee for purposes of voting for a period up to 10 years.

Generally, in the absence of express provision, if all shareholders are duly notified, or if the meeting is a regular one, any number of shareholders present represent a quorum, though they may represent less than a majority of shares. Their action, unless restricted by by-law, charter, or statute, binds the corporation. There is some conflict as to whether a quorum must be present at the time of voting. If a quorum has met, can members then withdraw or refuse to vote and thereby prevent the action of the meeting from becoming action of the quorum? Section 30 of the Act adopts probably the better view and provides that, except where otherwise provided in the Articles of Incorporation, the presence, by person or proxy of the holders of the majority of the voting power, shall constitute a quorum, and shareholders can continue to do business until adjournment, notwithstanding the withdrawal of enough shareholders to leave less than a quorum.

#### MANAGEMENT

With slight changes, Section 31 of the Act is substantially in accord with the Texas law regarding directors. Article 1320<sup>38</sup> requires at least three directors to manage the business. There is no statutory requirement that directors be shareholders in corporations organized under the general statutory provisions. Article 1323<sup>39</sup> requires, with four exceptions, election of directors to be held annually and any vacancy to be filled by the remaining board. Under this article a majority of the directors constitute a

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<sup>37</sup> *Withers v. Edwards*, 26 Tex. Civ. App. 189, 62 S. W. 795 (1901).

<sup>38</sup> TEX. REV. CIV. STAT. (Vernon, 1925) art. 1320.

<sup>39</sup> TEX. REV. CIV. STAT. (Vernon, 1925) art. 1323.

quorum. The Act adopts substantially the same provisions as the above statutes with minor changes and coordinates the law relating thereto.

Section 32 of the Act requires the directors to elect a president, secretary, and treasurer. Only the president need be a director. Article 1325<sup>40</sup> provides that the directors "choose one of their number president, and shall appoint a secretary and treasurer and other such officers as they shall deem necessary for the corporation."

Texas courts have generally held that directors are trustees for the stockholders and the corporation. But there is a vast difference between true trustees, in the ordinary sense of the word, and directors of a corporation. Some courts, including those of Texas,<sup>41</sup> have applied the same test to their trusteeship as is applied in the usual relation of trustee to the *cestui que trust*. However, it is probably the better view that a difference should be recognized and the directors considered agents of the corporation standing in a fiduciary status. Since the conflict over the degree of care to be exercised by the directors emanates largely from the status from which that relationship is viewed in a particular jurisdiction, Section 33 of the Act attempts to standardize that status by providing that the officers and directors stand in a fiduciary relation to the corporation. Their duties are to be performed "in good faith, and with the diligence, care, and skill which ordinarily prudent men would exercise under similar circumstances in like positions."

#### "REGISTERED OFFICE"

The concept of "Registered Office" in Section 34 of the Uniform Act eliminates the necessity of considering the comparative importance of different offices or places of business in a state, since it refers to the address of the business as registered with the

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<sup>40</sup> TEX. REV. CIV. STAT. (Vernon, 1925) art. 1325.

<sup>41</sup> *San Antonio & G. S. Ry. Co. v. San Antonio & G. R. Co.*, 25 Tex. Civ. App. 167, 60 S. W. 338 (1900).

Secretary of State and circumvents the ambiguity occasioned by such phrases as "principal place of business" used in existing state statutes. In Texas, where the charter does not designate the corporation's residence, the legal residence of the corporation is the place where it maintains its office and transacts its principal business. For purposes of venue, disregarding other advantages, clearly the Uniform Act evidences the more practical solution.

#### RIGHT TO INSPECT BOOKS

In the majority of jurisdictions, in the absence of statute, the stockholder has the right to inspect the corporate books if he makes proper demand for inspection at a reasonable time and for a proper purpose. Statutes in many states have been construed by courts as giving an absolute right of inspection, regardless of the motive or purpose of the shareholder. The courts of a few states having similar statutes, however, have construed them not to grant an absolute right where the motive is subversive or otherwise improper. Article 1328<sup>42</sup> provides that the books and records shall at all reasonable times be open to inspection of any stockholder, without any reference to the bona fides of the shareholder. The language is strong enough to establish an absolute right to examine the books, and the Texas court has held that such a right is given the shareholder.<sup>43</sup> However, the court did qualify the right by saying that a mandamus would not be issued to enforce that absolute right where the motives are improper. The discretionary power, then, that is incident to the issuance of a mandamus allows the court to read "motive" into our statute. Such circuitry of approach is avoided by Section 35 of the Act which makes the stockholder's right to inspect dependent, as at common law, on the reasonableness of the purpose or motive in making the demand.

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<sup>42</sup> TEX. REV. CIV. STAT. (Vernon, 1925) art. 1328.

<sup>43</sup> Moore v. Rock Creek Oil Corp., 59 S. W. (2d) 815 (Tex. Comm. App. 1933).

### SALE OF CORPORATE ASSETS

Few jurisdictions are without statutes regulating the sale by a corporation of its assets. By the weight of authority, if the corporation is in a prosperous condition and a sale is not necessary, the mere majority of stockholders may not sell the entire property with the intention of quitting business. Under Texas Article 1320 a corporation may sell its real or personal property. But this does not authorize directors to sell all of the assets of a prosperous business with the intention of dissolving. Article 1387<sup>44</sup> would require a vote of four-fifths of the stockholders in a meeting called for that purpose to effectuate such a disposition. However, a corporation may, if threatened by insolvency, by a majority vote of its stockholders, sell or dispose of its entire property. In cases of imminent necessity, where creditors are filing suit, directors alone may exercise this power of sale.<sup>45</sup>

Section 37 of the Act allows a voluntary sale of the assets of a corporation. If the corporation is solvent, the vote of the shareholders as provided in the Articles of Incorporation will authorize a sale or, in the absence of a specified percentage, a two-thirds vote will be necessary. If the corporation is insolvent, the board of directors may authorize the sale. In this provision, there is no material deviation from Texas decisions.

### AMENDMENTS OF CHARTER

Section 38 of the Act provides for amendment or extension of the corporate charter by shareholders' meeting. Under this section, if a proposed amendment alters the rights or preferences of the holders of any class of shares, then two-thirds vote of such holders, as a class, irrespective of other voting rights, is necessary for approval. Ordinary amendments require a two-thirds vote of the shareholders, or such vote as is required by the Articles of

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<sup>44</sup> TEX. REV. CIV. STAT. (Vernon, 1925) art. 1387.

<sup>45</sup> Howard v. Republic Bank & Trust Co., 76 S. W. (2d) 187 (Tex. Civ. App. 1934).

Incorporation. In Texas Article 1315<sup>46</sup> permits a solvent corporation to extend its charter by a resolution of a mere majority of shareholders; and Article 1314<sup>47</sup> allows amendment to be made in the same manner as prescribed for the original charter, so long as not violative of the Constitution or other laws or the original purpose for which the corporation was created.

#### INCREASE AND REDUCTION OF CAPITAL

Under Article 1330<sup>48</sup> a corporation may increase capital stock and issue preferred stock upon a two-thirds vote of stockholders having voting privileges. A mere majority of voting shareholders under Article 1538(h)<sup>49</sup> may amend the charter to provide for par and/or non-par stock as long as there is no impairment of rights or privileges of any class without the holders' consent. In this respect, the protection that is afforded the shareholders under the Texas statutes seems to be more desirable, since the shareholder should be free to assume that his stock will not be impaired by subsequent corporate amendment to which he individually does not assent. However, with the exception of certain specified instances, the general statutes in Texas and Article 1314 are silent as to the percentage vote that is required for the validity of amendments.

Section 41 of the Act provides for the reduction of capital stock of a corporation by a resolution adopted by two-thirds vote of the shareholders at a meeting called for that purpose. Articles of Reduction are required to be filed with the Secretary of State showing the financial condition of the corporation and that the reduction will not impair the existing debts and liabilities.

#### MERGER AND CONSOLIDATION

Independently of statute, unanimous consent of shareholders is

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<sup>46</sup> TEX. REV. CIV. STAT. (Vernon, 1925) art. 1315.

<sup>47</sup> TEX. REV. CIV. STAT. (Vernon, 1925) art. 1314.

<sup>48</sup> TEX. REV. CIV. STAT. (Vernon, 1925) art. 1330.

<sup>49</sup> TEX. REV. CIV. STAT. (Vernon, 1925) art. 1538(h).

generally necessary to sustain certain corporate acts, such as consolidation or merger, transfer of assets, or radical amendment. However, statutes have been passed in many states granting wide powers to specified majorities in such matters. In enacting these statutes, many legislatures realized the necessity of an ancillary protection or remedy to the dissenting shareholder; that although a small group should not be able to prevent the majority from doing with the corporation what they deem most expedient, yet the minority should not be forced to continue in an enterprise radically different from the venture upon which they originally embarked, or in an essentially altered status.<sup>50</sup> Accordingly, Section 42 of the Act provides for the repayment of the value of the shares to the dissenting shareholder if the corporation would be solvent after such payment where the corporation has (a) authorized the sale, lease, or exchange of all of its assets, (b) authorized an amendment changing the corporate purpose or extending duration, or (c) changed the rights of the holders of any outstanding shares.

Generally, corporations can consolidate or merge lawfully only where expressly permitted to do so by statute. In Texas there are various statutory and constitutional provisions authorizing merger and some specific prohibitions.<sup>51</sup> Sections 43 to 48 of the Act deal with consolidation, and constitute a codification of the more general concepts of that problem. Section 42 of the Act, however, is silent on the matter of prohibited consolidations, providing that "any two or more domestic corporations . . . or any domestic corporations and foreign corporations" may consolidate. Sections 49 to 60 of the Act deal with the problems of dissolution of private corporations.

#### CONCLUSION

The Uniform Act, as drafted, does not purport to offer an infallible solution to the ever-increasing complexities encountered

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<sup>50</sup> See Levy, *Rights of Dissenting Shareholders to Appraisal and Payment* (1930) 15 CORN. L. Q. 420.

<sup>51</sup> See 3 HILDEBRAND, *TEXAS CORPORATIONS* (1942) § 985.

in the many fields of present-day corporate endeavor, yet it would be but a truism to say that the Act is a substantial attempt at advancement of uniform corporate legislation. The Act has been based upon the experience of the various states, and where conflict in policy or statute has been encountered, the Commissioners have selected the policy which appeared to be supported by the majority of the courts or the better reasoning.

*John R. Wilson.*

