Corporations and Partnerships

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The practice of corporate law has become increasingly a matter of taxation and securities regulation, both Texas and federal. The statute that undoubtedly has the greatest day-to-day impact on an attorney's corporate practice is the Internal Revenue Code of 1954. The Code was massively amended by the Tax Reform Act of 1976 which significantly changed many of the basic ground rules of business law practice. For example, the deductibility of losses arising from most so-called "tax shelters" are limited to the amount the taxpayer had at risk. As a result, the widespread use of non-recourse loans has come to a screeching halt. The holding period for long term capital gains was increased to nine months for 1977 and to twelve months thereafter. The minimum tax on tax preferences was increased from ten percent to fifteen percent and new tax preference items were added. The special tax treatment for qualified stock options as a compensation device was abolished for options created after May 20, 1976, and the complex interplay of tax concepts applicable to the exercise of qualified options acquired before that date reduce their attractiveness even further. Future compensation devices for corporate executives will therefore take new forms. The Tax Reform Act made so many changes that it is important to look at the Code for the possibility of amendment whenever new tax-related issues arise.

I. LEGISLATIVE AND ADMINISTRATIVE DEVELOPMENTS

The 1977 session of the Texas Legislature made a number of changes in applicable statutory provisions relating to corporations and partnerships. While none of the changes can be classified as major, they are quite numer-

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2. I.R.C. § 465. These "tax shelters" include certain farming equipment leasing, motion picture, video tape, and oil and gas well activities.
3. Id. § 1222.
4. Id. §§ 56(a), 57(a).
5. See Moffit, Executives Make Some Mistakes in Exercise of Stock Options; Extra Taxes May Result, Wall St. J., Nov. 14, 1977, at 34, col. 1. This article points out that in some circumstances a corporate executive may be better off treating the entire gain as ordinary income—compensation for personal services.
6. Such devices may include restricted stock plans pursuant to which the corporation transfers stock to an employee subject to restrictions that affect its value. The excess of the fair market value over cost is taxed to the employee when the stock is no longer subject to the restriction, but the employee may elect to have the value of the restricted stock taxed to him in the year in which it is received. I.R.C. § 83. In the latter event, however, no deduction is allowed if the property is later forfeited. Another device is stock appreciation rights (SARs) which give employees the advantages of a stock option without actually requiring a purchase or holding of the stock. SARs are exempted from § 16(b) of the Securities Exchange Act of 1934, 17 C.F.R. § 240.16b-3 (1977).
ous. Both the Texas Securities Board and the Securities and Exchange Commission also made significant regulatory changes during the survey period.

A. Assumed Names

Chapter 36 of the Texas Business and Commerce Code is a comprehensive set of statutory provisions relating to the use of assumed business or professional names, replacing the somewhat ambiguous and skeletal provisions of prior law. The Act requires that a person conducting business under an assumed name must file a certificate with the county clerk in each county in which such person has or will maintain business or professional premises. In addition, a foreign or domestic corporation conducting business under an assumed name must file a certificate with the secretary of state and with the county clerk in the county in which its registered or principal business office is located. A major innovation of chapter 36 is a set of carefully drafted definitions, including in particular a definition of “assumed name” that materially assists in determining whether the filing of a certificate is required.

The required contents of the certificate for individuals, partnerships, estates, real estate investment trusts, companies, and corporations are all carefully spelled out in the statute. The secretary of state is authorized to promulgate permissive forms relating to assumed names and has done so for corporations.

Each certificate is effective for a period of ten years, unless a shorter period is designated, and a new certificate must be filed if events occur that

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7. TEX. BUS. & COMM. CODE ANN. §§ 36.01-.26 (Vernon Supp. 1978). Chapter 36 may be cited as the "Assumed Business or Professional Name Act."
8. Id. § 36.10.
9. Id. § 36.11.
10. Id. § 36.02(7) provides:
(A) in the case of an individual, a name that does not include the surname of the individual;
(B) in the case of a joint venture or general partnership, a name that does not include the surname or other legal name of each joint venturer or general partner;
(C) in the case of an individual, joint venture, or a general partnership, a name, including a surname, that suggests the existence of additional owners by including words such as 'Company,' '& Company,' '& Son,' '& Sons,' '& Associates,' 'Brothers,' and the like, but not words that merely describe the business or professional service being conducted or rendered;
(D) in the case of a limited partnership, any name other than the name stated in its certificate of limited partnership;
(E) in the case of a company, any name used by the company; and
(F) in the case of a corporation, any name other than the name stated in its articles of incorporation or association or comparable document.
11. Id. § 36.11(c) specifically resolves a question on which there was some uncertainty under prior law:
Nothing in this chapter shall require a corporation or its shareholders, associates, or members to file an assumed business or professional name certificate in order to conduct business or render a professional service within this state under the name of the corporation as stated in its articles of incorporation, association, or comparable document.
14. Id. § 36.13(a).
make the filing "materially misleading." The most common events that require the filing of a new certificate are specified. Failure to file a certificate when one is required will close the courts of the state to the person until the proper certificate is filed; further, conducting business or rendering a professional service under an assumed name that violates a provision of chapter 36 constitutes a misdemeanor punishable by a fine not to exceed $2,000.

A transition period for replacing outstanding assumed name certificates with certificates complying with chapter 36 expires December 31, 1978. Each county clerk is directed to notify all persons having outstanding assumed name certificates of the new requirements. Both county clerks and the secretary of state are directed to maintain alphabetical lists of all assumed names filed in their respective offices. The filing fees are established by statute as $2.00 for filing in county clerks' offices and $10.00 for filing in the secretary of state's office.

B. Foreign Limited Partnerships

The status of foreign limited partnerships doing business in Texas was uncertain under prior law. Cautious attorneys recommended that a limited partnership created under the laws of some other state file a certificate in the office of the secretary of state if it planned to transact business in Texas and wished to insure that its limited partners would not become liable on obligations arising from its activities in Texas.

The new section 32 of the Texas Uniform Limited Partnership Act provides for the qualification of a foreign limited partnership to transact business in Texas in a manner similar to that applicable to foreign corporations. In order to qualify, a foreign limited partnership must file a qualification statement, its certificate of limited partnership (or equivalent document) together with all amendments, and must pay a filing fee based on the capitalization of the limited partnership identical to the filing fee applicable to a domestic limited partnership. Upon qualification a foreign limited

15. *Id.* § 36.12.
16. *Id.* § 36.12(b) provides:

An event that causes the information contained in a certificate filed under this chapter to become materially misleading includes such matters as:

1. a change in the name, identity, entity, form of business or professional organization, or location of a registrant;
2. in the case of a proprietorship or sole practitioner, a change in ownership;
3. in the case of a partnership, the admission of a new partner or joint venturer or whenever any general partner or joint venturer ceases to be associated with the partnership; or
4. in the case of a registrant that is required by law to maintain a registered or similar office and a registered or similar agent at such office, a change in the address of such office or identity of such agent.

17. *Id.* § 36.25. The last sentence of this section adds: "In an action or proceeding brought against a person that has not complied with this chapter, the plaintiff or other party bringing the suit or proceeding may recover, if the court shall so determine, expenses incurred, including attorney's fees, in locating and effecting service of process on such person."
18. *Id.* § 36.26.
19. *Id.* §§ 36.13(d), (e).
20. *Id.* § 36.15.
22. *Id.* §§ 32(b)(3), (d). The computation of this fee is discussed in 19 R. Hamilton, supra note 12, § 212.
partnership enjoys the same rights and privileges, and is subject to the same
duties, restrictions, and liabilities as a domestic limited partnership. A
qualified foreign limited partnership must maintain a registered agent and
registered office in Texas; the limited partnership, and at least one general
partner, must consent to service of process in Texas for the enforcement of
obligations of the limited partnership. The secretary of state has prepared
forms for qualification of foreign limited partnerships under section 32.25

C. Incorporation of a Going Business

Article 1302—2.02A of the Texas Miscellaneous Corporation Laws Act
provides that if a "banking, mercantile or other business firm" incorporates
without "a change of firm name" notice must be published, and if this
notice is not published, "no change shall take place in the liability of such
firm or the members thereof." The scope of this provision has been
extensively litigated. A major issue in much of the litigation has been
whether a plaintiff could take advantage of this provision even though he
had actual knowledge of the incorporation. This issue was finally resolved
by legislation in 1977 which added the following sentence to article 1302—
2.02: "It shall be a defense that a claimant had actual notice or knowledge of
such incorporation."26

Article 1302—2.02A was involved in one case that arose during the survey
period. In Stein v. Hooker Industries, Inc. the individual had transacted
business with the plaintiff under the name "Speed & Sport Warehouse";
thereafter the business was incorporated under the name "Speed & Sport
Warehouse, Inc." Holding that under such circumstances the defendant had
the burden of proof to show actual knowledge, the court concluded that the
mere fact that some of the checks used after incorporation had been imprint-
ed "Speed & Sport Warehouse, Inc." did not give notice of such incorpora-
tion. The court, after reviewing the prior case law under Article 1302—2.02,
suggested that earlier cases were distinguishable because "we . . . have a
situation before us where there were previous dealings between the seller
and buyer." Justice Cadena concurred, but he added that he would affirm
"without suggesting that article 1302-2.02 applies only where the creditor
has previously . . . extended credit to" the debtor. The question involved
in this case will, of course, continue to arise under the recent amendment.

D. Failure to Pay Franchise Taxes

Article 12.14 of the General Taxation Statutes provides a powerful
incentive to keep the payment of franchise taxes current. The article creates
personal liability in certain corporate officers or directors for corporate

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23. TEX. REV. CIV. STAT. ANN. art. 6132a, § 32(c) (Vernon Supp. 1978).
24. Id. §§ 32(b)(2)(C), (j).
25. See 19 R. HAMILTON, supra note 12, § 221.
27. See 19 R. HAMILTON, supra note 12, § 235.
29. 545 S.W.2d 487 (Tex. Civ. App.—San Antonio 1976, writ ref'd n.r.e.).
30. Id. at 490.
31. Id. at 491.
obligations created after the right to do business is forfeited for non-payment of franchise taxes. This statute has also given rise to considerable litigation in the past. In 1977 the statute was divided into three numbered paragraphs and the last paragraph was revised to read:

(3) Each director and officer of any corporation whose right to do business within this State shall be so forfeited shall, as to any and all debts of such corporation, which shall include all franchise-taxes and penalties thereon which shall become due and payable subsequent to the date of such forfeiture, and which may be created or incurred within this State, after the report or payment becomes due and before the revival of the right of such corporation to do business, be deemed and held liable thereon in the same manner and to the same extent as if such directors and officers of such corporation were partners. However, any officer or director may avoid liability if he shows that the debt was created (1) over his objection, or (2) without his knowledge, if the exercise of reasonable diligence to acquaint himself with the affairs of the corporation would not have revealed the intention to create the debt.

This provision differs from prior law in two basic respects:

(1) Formerly, personal liability existed only with respect to debts created with the officer’s or director’s “knowledge, approval and consent”; the revised article 12.14 imposes liability unless the officer or director can show affirmatively that the debt was created over his objection or without his knowledge “if the exercise of reasonable diligence to acquaint himself with the affairs of the corporation would not have revealed the intention to create the debt.” In other words the burden is no longer on the creditor to show knowledge of the officer or director to disprove knowledge or the possibility of knowledge. In addition the standard for finding non-liability appears to have been narrowed.

(2) Personal liability exists with respect to all debts incurred after the report or payment becomes due, assuming that the corporation’s right to do business is thereafter forfeited; under prior law personal liability existed only with respect to debts created after the right to do business is forfeited. An internal memorandum of the comptroller of public accounts describes this effect as follows:

That is, if the annual report, which is due June 15, is not filed and the corporation’s right to do business is forfeited on September 15, the officer’s personal liability is for debts created after June 15. Previously the risk of personal liability is for debts created after September 15.

E. Information Collected by the Comptroller

Beginning in 1977, and once each year thereafter, each corporation must submit to the comptroller of public accounts a list containing the following: the name, title, and mailing address of each director and officer; the name of each corporation in which the corporation filing the report owns a ten

33. See 19 R. HAMILTON, supra note 12, § 235.
35. Id.
percent or greater interest; and the name of each corporation which owns a
ten percent or greater interest in the corporation filing the report. These
reports are forwarded to the secretary of state and are available for public
inspection. The comptroller has prepared a mandatory form for complying
with these requirements which, for the first time, may provide reasonably
up-to-date information about current participants in corporations.

The administration of the ten percent requirement, however, may prove
troublesome. It is unclear, for example, whether indirect ownership is to be
counted toward the ten percent requirement, or whether only pure record
ownership need be taken into account. These questions presumably will
initially be resolved by each corporation since the comptroller has given no
guidance on such matters in the mandatory form.

F. Amendments to the Texas Securities Act

Section 33 of the Texas Securities Act, the basic civil liability section of
that Act, was completely rewritten and greatly expanded in 1977. Liability
was extended to buyers who purchase on the basis of materially false or
incomplete representations, to issuers which register securities for secondary
distribution, and to control persons and aiders of securities act violations.
Further, the requirements of an offer to rescind in the variety of circumstances
now covered by the section are clearly spelled out. The statute of limitations
was also rewritten to reflect the complexities of the expanded statute, although the basic three-year statute was retained. The
revisions of section 33 bring the Texas statute much closer to federal law,
particularly rule 10b-5. In light of the recent decisions of the United States
Supreme Court narrowing the scope of that rule, this section of the Texas
Securities Act is likely to assume greater importance in the future.

The legislature also enacted a number of technical amendments prepared
by the Texas Securities Board. These included a uniform fee schedule for
licenses instead of the prior complex and confusing system. The new
schedule makes clear that the fee for registering securities is computed only
on the aggregate amount of securities proposed to be sold in Texas and to
investors located in this state.

G. Sunset Act

The State Securities Board was made subject to the Texas Sunset Act.

38. White, Changes in Filings for Secretary of State, 40 Tex. B.J. 845 (1977). The comptroller currently maintains a microfilm record of such written submissions. The secretary of state will supply the information so developed upon written request and payment of a $2.00 handling fee. Telephone requests cannot be handled.
42. These cases include Santa Fe Indus., Inc. v. Green, 430 U.S. 462 (1977); Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975).
43. Id. art. 581-35.
44. Id. art. 581-2(f).
and is scheduled for review under that Act before September 1, 1983. Unless continued by the legislature it will be abolished on that date. The secretary of state is a constitutional office and is treated differently. It will be reviewed at the time agencies scheduled for abolishment on September 1, 1989, are reviewed, but, is not itself subject to abolishment.46

H. Penalties for Corporate Criminal Conduct

The legislature also made adjustments to the schedule of fines applicable to corporations convicted of criminal conduct carrying potential sentences of imprisonment for individuals. Such fines were increased to $20,000 for a felony, $10,000 for a class A or class B misdemeanor, and $2,000 for a class C misdemeanor. A further provision was added authorizing a fine equal to twice the personal injury, property damage, or other loss caused through criminal conduct constituting a felony or class A or class B misdemeanor. Finally, a corporation may be compelled to notify any person the court deems appropriate of the fact of such conviction.47

I. Tender Offers

A number of states have adopted statutes regulating tender offers.48 Such legislation was proposed for Texas, but it was withdrawn when the Texas Securities Board adopted regulations that contained analogous provisions. The regulations are described as “administrative guidelines for minimum standards in tender offers” and provide that offers not meeting the standards will be looked on “with disfavor.”49 An intention to make a tender offer must be disclosed to the Securities Commissioner at least twenty-one days prior to the offer, and the offer itself must remain open for twenty-one days. Other provisions require full disclosure, pro rata acceptances when less than all tenders are accepted, and retroactive effect of increases in price to cover shares tendered previously.50

Federal law, however, will continue to affect the tender offer area significantly. A district court in Texas has held invalid the Idaho tender offer statute on the ground that the subject is preempted by federal legislation—the Williams Act.51 The SEC is considering regulatory action that would revise its regulations under the Williams Act.52 Tender offers for shares of large corporations (sales of $10,000,000 or more if a manufacturing corporation, or assets of $10,000,000 or more if not) may be subject to a fifteen-day waiting period, for review by the Federal Trade Commission and the Antitrust Division of the Department of Justice, if the offeror meets certain size requirements.53 Finally, in Piper v. Chris-Craft Industries, Inc.,54 a case

46. Id. art. 4330a.
47. Tex. Pen. Code Ann. § 12.51 (Vernon Supp. 1978). Prior to 1977 the schedule of fines was $10,000, $2,000, and $200, respectively, and a fine based on the size of the transaction was limited to twice the amount of money or property gained from the transaction.
49. Tex. Sec. Bd. Reg. 065.15.00.100(b).
50. Id. 065.15.00.400(a), (c), (d), (f), (g).
54. 430 U.S. 1 (1977). For a discussion of the persons who may have standing, consult
having considerable significance for the doctrine of implied causes of action and the development of federal securities law generally, the United States Supreme Court held that an unsuccessful contender for control of a target company does not have standing to sue for damages under the Williams Act.

J. Securities Regulation

The SEC has under active review the entire question of shareholder participation in large public corporations. As part of that review it made significant changes in its shareholder proposal regulation, while calling for further study of the entire area. The current rules relating to shareholder proposals can be briefly summarized:

1. The proposal must be timely submitted, which in the case of an annual meeting must be not less than ninety days in advance of a date corresponding to the date set forth on management's proxy statement in the previous year;
2. The proposal may be omitted if:
   a. it is not a proper subject for action by security holders under the law of the issuer's domicile;
   b. it would require the issuer to violate any state, federal, or foreign law if implemented;
   c. it is contrary to any of the SEC's proxy regulations;
   d. it relates to the enforcement of a personal claim or the redress of a personal grievance, against the issuer, its management, or any person;
   e. it deals with a matter that is not significantly related to the issuer's business;
   f. it deals with a matter that is beyond the issuer's power to effectuate;
   g. it deals with a matter relating to the ordinary business operations of the issuer;
   h. it relates to specific amounts of dividends;
   i. the proposal is moot;
   j. the proposal is either counter to a proposal by management or substantially the same as a proposal by another shareholder which will be included in the proxy materials; or
   k. substantially the same proposal has previously been submitted to the shareholders within the previous five years and failed to receive specified percentages of the vote, depending on the number of times it was submitted previously;
3. A proponent may submit a maximum of two proposals not exceeding an aggregate of 300 words; and
4. The accompanying statement for each proposal may not be more than 200 words.

Aranow, Berlstein & Einhorn, Standing to Sue to Challenge Violations of the Williams Act, 32 Bus. Law 1755 (1977).
55. Hearings on shareholder communications, participation in corporate elections, and corporate governance were held by the SEC in September and October 1977. SEC. REG. & L. REP. (BNA) No. 422, at A-3.
57. Id.
In 1976 the SEC also significantly relaxed the requirements for registering restricted or letter stock. Where the corporation has registered a class of securities under the Securities Exchange Act of 1934, and is complying with the continuous disclosure requirements of that Act, registration on form S-16 is permitted. Typically this completed form runs only three or four pages and incorporates by reference most financial information. The cost of preparing such a registration statement is only a small fraction of a full-scale registration.

II. Judicial Developments

A. Partnership

Interesting and challenging partnership cases continue to arise in Texas. Three cases during the survey period involve the question of whether, under the particular circumstances, a partnership was formed. These cases reveal that misconceptions continue on the part of some Texas appellate judges as to the legal test for the existence of the partnership relationship. Section 6 of the Texas Uniform Partnership Act provides that a partnership “is an association of two or more persons to carry on as co-owners a business for profit.” Further, section 7(4) provides the “receipt by a person of a share of the profits of a business is prima facie evidence that he is a partner in the business, but no such inference shall be drawn” if the profits were to be received as repayment of a debt, or as wages, rent, interest, or other relationship.

There is no reference to a sharing of losses as an essential element of the partnership relation, although a sharing of losses is a consequence of the partnership relation since section 18(1)(a) provides that “subject to any agreement between them . . . each partner . . . must contribute towards the losses, whether of capital or otherwise, sustained by the partnership according to his share of the profits.” Under section 18 the partners can, by agreement, allocate the losses differently from the profits without affecting the existence of the partnership relation. For example, all the losses may be allocated to partner B while the profits are shared equally between partners B and C.

The one case that seems most clearly to misapply these principles is *Tex-Co Grain Co. v. Happy Wheat Growers, Inc.* In this case several ranchers entered into a written “joint venture” agreement with a feedlot by which the

58. Id. § 239.27 (1977).
60. TEX. REV. CIV. STAT. ANN. art. 6132b, § 6 (Vernon 1970).
61. Id. § 7(4). A sharing of gross returns does not give rise to an inference that a partnership exists. Id. § 7(3).
62. Id. § 18(1)(a).
63. Section 15 of the Texas Uniform Partnership Act provides that all partners are jointly and severally liable for all partnership obligations. Section 15 is not qualified by “subject to any agreement between them” as is § 18. As a result, in the above hypothetical, partner B is fully liable for partnership obligations but may claim reimbursement from the partnership if it is solvent. In the event the partnership is insolvent he can compel A to reimburse him, if A is solvent. If A is insolvent B will have to bear all losses despite his agreement.
64. 542 S.W.2d 934 (Tex. Civ. App.—Amarillo 1976, no writ).
feedlot would accept, feed, and maintain the ranchers’ cattle. After the cattle were sold, the profits would be shared; if the expenses exceeded the selling price, the feedlot would bear the loss. The court treated the issue as to whether a partnership existed as an “issue of fact” and concluded that the “prima facie evidence” of section 7 was negated because there was “no mutual control over the affairs of the Feedlot or the affairs of the defendants. No tangible property was owned in common. Losses and expenses were not shared by the defendants.”65 Thus, even though the relationship admittedly did not fall within any of the exempted categories of section 7, no partnership was created; the court did not describe what the relationship was.

Taylor v. Lewis66 involved an agreement by Taylor to manage a new motel for a stated salary, and an agreement that when there were profits, Taylor “was to receive ten percent of the profits to be applied toward the purchase of a ten percent interest in the motel as determined by the cost of the land and the construction.”67 During and after construction, Taylor actively participated in furnishing the motel; he was listed as an “owner” on a liquor license application, an assumed name certificate, the partnership tax return for 1972 (but not for 1973), and similar documents; he was publicly referred to on a few occasions as a “partner”; and he executed a note on behalf of the partnership. Things, however, did not work out as contemplated: the motel was not profitable and Taylor was ultimately fired without his ever having paid ten percent of the construction cost or receiving in any formal way an interest in the partnership or in the motel. Further, there was an appreciable amount of conflicting evidence that Taylor was not considered to be a partner, and that the partnership indicia described by Taylor had not been approved by all the other partners.

The partnership issue was submitted to a jury with the following instruction:

By the term ‘partnership’ is meant a relationship between two or more persons where there is a common enterprise and a community of interest as co-owners therein, a prosecution of the common enterprise for the joint benefit of the parties, and a right of each of the parties to participate to some extent in the profits as such and an obligation of each of the parties to bear some portion of the losses, if any, sustained in the business.68

During its deliberations the jury asked for an expansion of the meaning of “co-owners”; the court declined, specifically refusing Taylor’s oral request that the jury be told that the term “was not limited to those who contributed property but included those who became co-owners by reason of contribution of services.”69

In another questionable part of the opinion the court of civil appeals held

65. Id. at 937.
66. 553 S.W.2d 153 (Tex. Civ. App.—Amarillo 1977, writ ref’d n.r.e.).
67. Id. at 155.
68. Id. at 158.
69. The court alternatively held that failure to put the request in writing constituted a waiver under rule 279 of the Texas Rules of Civil Procedure. Id. at 159.
70. Id. at 158.
that even though the trial judge should have given the jury further direction, the failure to do so was not reversible error, since the term co-owners had a commonly understood meaning of joint owners or owners together. The court added that "the term needs no definition for the juror of average intelligence, who would be presumed to construe the use of the word in its usual and ordinary sense." While this conclusion appears reasonable on its face, it appears that the jurors, or at least some of them, thought that co-ownership required a financial investment in the motel itself, and concluded that a partnership did not exist because Taylor had never made the required investment. In any event, after finding that the refusal to give further instructions did not constitute reversible error, the court concluded that the jury verdict that no partnership existed was not against the great weight of the evidence.

The final case, *Howard Gault & Son v. First National Bank*, involved all the question of whether a bank was liable for honoring a check payable to "Thomas & Gault" on the endorsement:

- "Thomas & Gault"
- "T.B. Thomas, Jr."

The basic issue was whether Thomas was a partner with the corporate plaintiff, Howard Gault and Son, Inc. The plaintiff owned or leased certain farmland. Thomas agreed to farm this land on the following terms: plaintiff was to receive a crop rental, and extend financing including a monthly "draw" for Thomas chargeable against Thomas' distributive share; Thomas was to furnish his own equipment and personal labor; all other expenses were to be divided equally and the net revenues, rents, and proceeds were to be divided equally. The written agreement specifically stated the parties were not partners but were landlord and tenant.

The court quite correctly concluded that the mere statement that a landlord-tenant relation existed was not conclusive, since "[i]t is the intent to do the things that constitute a partnership that determines the relationship . . . and if [the parties] intend to do a thing which in law constitutes a partnership, they are partners whether their expressed purpose was to create or avoid the relationship." On considering the evidence the court ruled that "as a matter of law, their farming operation was a partnership.

Each of these cases recognized that sections 6 and 7 of the Texas Uniform Partnership Act controlled the central issue. There was sharp disagreement, however, as to whether the issue is for the court or for the jury, and apparent disagreement as to the proper test. The conclusions, however, seem result oriented, and based on the equities of the particular case; *Happy Wheat Growers* involved an attempt to hold "secret" partners liable on a debt that had been created on the belief that the feedlot was solely liable, while the Hereford First National Bank reasonably assumed that a check to Thomas & Gault was a check made payable to a partnership and that either partner might endorse it.

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71. *Id.* at 159.
73. *Id.* at 237.
74. *Id.*
Cox Enterprises, Inc. v. Filip\(^7\) is one of the few partnership-by-estoppel cases to arise in recent years under section 16(1) of the Texas Uniform Partnership Act.\(^6\) An employee of the alleged partnership filled out a credit application to Cox Enterprises for newspaper advertising which listed Elliott as an owner along with Filip, an admitted owner. The employee testified that Elliott knew he was listed on the credit application, but Elliott testified that he did not authorize his name to be included. The district court believed Elliott and ruled that he did not consent to being held out as a partner. The court of civil appeals found that his conclusion was not against the great weight of the evidence.

The district court also found that Elliott failed to exercise ordinary care to discover whether he had been held out as a partner, but refused to give judgment against him on this ground. The court of civil appeals agreed, holding that there is no affirmative duty under section 16(1) of the Texas Uniform Partnership Act to seek out all those who may represent to others that he is a partner.\(^7\) Section 16(1) speaks not to due care but to knowledge and consent, and Cox failed to prove that Elliott consented to being held out as a partner. Such cases essentially turn on their facts, however, and can go either way, depending upon whether the alleged partner knew that he was being held out as a partner and whether he consented. The basic lesson is that there is real risk for persons who allow themselves to be held out as partners by listing on a letterhead, by being introduced as partners, by signing a credit application as a joint owner, or by other means. Such persons may be held liable as a partner even though they do not have the traditional partnership and profit sharing intent.

Section 21 of the Texas Uniform Partnership Act imposes a fiduciary duty upon partners in their dealings with each other.\(^8\) This broad duty, which has been described as one of the "highest recognized in the law,"\(^9\) extends to all aspects of their dealings, even when there has been a significant falling-out between them.\(^8\) In appropriate cases, exemplary damages may be im-

\(^{75}\) 538 S.W.2d 836 (Tex. Civ. App.—Austin 1976, no writ).
\(^{76}\) TEX. REV. CIV. STAT. ANN. art. 6132b, § 16(1) (Vernon 1971) provides:
(1) When a person, by words spoken or written or by conduct, represents himself, or consents to another representing him to any one, as a partner in an existing partnership or with one or more persons not actually partners, he is liable to any such person to whom such representation has been made, who has, on the faith of such representation, given credit to the actual or apparent partnership, and if he has made such representation or consented to its being made in a public manner he is liable to such person, whether the representation has or has not been made or communicated to such person so giving credit by or with the knowledge of the apparent partner making the representation or consenting to its being made:
(a) When a partnership liability results, he is liable as though he were an actual member of the partnership;
(b) When no partnership liability results, he is liable jointly with the other persons, if any, so consenting to the contract or representation as to incur liability, otherwise separately.
\(^{77}\) 538 S.W.2d at 838.
\(^{78}\) TEX. REV. CIV. STAT. ANN. art. 6132b, § 21(1) (Vernon 1970) provides:
Every partner must account to the partnership for any benefit, and hold as trustee for it any profits derived by him without the consent of the other partners from any transaction connected with the formation, conduct, or liquidation of the partnership or from any use by him of its property.
\(^{79}\) Huffington v. Upchurch, 532 S.W.2d 576, 579 (Tex. 1976).
\(^{80}\) See, e.g., Johnson v. Peckham, 132 Tex. 148, 120 S.W.2d 786 (1938).
posed on a partner who breaches this duty.\textsuperscript{81}

In \textit{Kunz v. Huddleston}\textsuperscript{82} the parties entered into a verbal partnership agreement to construct and manage some small drive-in shopping centers. Huddleston agreed to find the locations, tenants, and financing while Kunz agreed to construct the centers through his eighty-five percent-owned construction company. Subsequently a written agreement was entered into which provided that neither party would receive any salary or compensation for services during the acquisition, financing, construction, and leasing of the stores. Despite this provision Kunz, through his construction company, submitted bills for work which reflected a profit to the construction company. Huddleston objected and refused to pay; the construction company then filed a lien on the property, which resulted in the loss of a loan commitment. At this point the construction company attempted to foreclose the lien and suit was brought to dissolve the partnership and obtain an accounting. Reaffirming the broad fiduciary duties described above, the court held that Kunz was responsible for his construction company's activities because there was a principal/agent relationship, and that Kunz violated his fiduciary duty which constituted a fraud on Huddleston. Basic findings of fact to support these conclusions had been made by a jury. Finally, the court held that, as the guilty party, Kunz was not entitled to attorneys' fees for seeking to enforce his claim for payment of construction costs, and that Huddleston, who might have claimed his fees from the partnership under section 18(1)(b) of the Texas Uniform Partnership Act,\textsuperscript{83} was not entitled to do so because he had failed to submit a claim for them.

\textit{Johnson v. Buck}\textsuperscript{84} involved even more egregious misconduct by one partner toward another. The jury found, and the appellate court agreed after a careful review of the facts, that a managing partner had made significant misrepresentations and concealed material facts to induce a copartner to sell his interest in partnership properties. It was no defense that the managing partner offered to sell his interest at the same price because the managing partner knew that the selling partner was in financial difficulties and did not have the resources to purchase the managing partner's interest. Indeed, this offer gave the misrepresentations and concealment greater force than they would otherwise have had. A judgment for more than six million dollars was affirmed.

The final partnership case during the survey period involved essentially a question of pleading. In \textit{Ingram v. Card Co.}\textsuperscript{85} suit was brought against “William R. Ingram and S.L. Hutcheson d/b/a Hutcheson and Ingram Development Company.” The only answer filed was by “William R. Ingram d/b/a Hutcheson-Ingram Development Company.” Thereafter an interlocu-

\begin{itemize}
\item \textsuperscript{81} See, e.g., Morgan v. Arnold, 441 S.W.2d 897 (Tex. Civ. App.—Dallas 1969, writ ref’d n.r.e.).
\item \textsuperscript{82} 546 S.W.2d 685 (Tex. Civ. App.—El Paso 1977, writ ref’d n.r.e.).
\item \textsuperscript{83} \textsc{Tex. Rev. Civ. Stat. Ann.} art. 6132b, § 18(1)(b) (Vernon 1970) provides: “The partnership must indemnify every partner in respect of payments made and personal liabilities reasonably incurred by him in the ordinary and proper conduct of its business or for the preservation of its business or property.”
\item \textsuperscript{84} 540 S.W.2d 393 (Tex. Civ. App.—Corpus Christi 1976, writ ref’d n.r.e.).
\item \textsuperscript{85} 540 S.W.2d 803 (Tex. Civ. App.—Corpus Christi 1976, no writ).
\end{itemize}
tory default judgment was entered against "Hutcheson and Ingram Development Company, a partnership" which subsequently became final. On appeal the court held that Ingram’s answer was an answer for the partnership rather than an answer by himself individually. While the result seems reasonable under the circumstances, the case highlights the importance of recognizing that for many purposes a partnership should be treated as an entity distinct from the partners, and that pleading on behalf of a partnership should be phrased so as to cover the partnership as well as the partner actually signing the pleading.

B. Corporations and Securities Regulation

The Recognition of Separate Corporate Existence. Cases involving the amorphous doctrine of "piercing the corporate veil" continue to arise. They have been a feature of every Annual Survey article since this journal commenced this series.86 Hanson Southwest Corp. v. Dal-Mac Construction Co.87 is a well reasoned case refusing to hold a parent corporation liable on a contract entered into by a subsidiary, which was wholly owned and totally controlled by the parent. Recognizing that a more stringent standard was applicable in contract cases than in tort cases, the Dallas court of civil appeals concluded that the following facts were not sufficient to make the parent liable for the subsidiary’s default:

(a) The negotiations were conducted by an officer of the subsidiary who identified himself as being with the “Hanson Companies”;

(b) The officer furnished Dal-Mac’s representative with copies of Topics, a publication of the Hanson Companies devoted to potential shopping center tenants;

(c) This publication listed centers as being operated by “Hanson Companies” regardless of which of several related corporations actually owned the center;

(d) Dal-Mac’s representative unsuccessfully sought to obtain a credit report on the subsidiary. Fearing that the subsidiary might be a “shell,” he requested that performance of the contract be guaranteed by the Hanson brothers personally or by the parent corporation. After the contract was entered into, he was told that the Hanson brothers would not make a personal guarantee but that a “financial assurance” was in the mail. The court concluded that a financial assurance was not tantamount to a promise to guarantee performance since a third party loan commitment might also constitute such an assurance, and that even if false it had not been a motivating factor in entering into the contract.

The court’s general discussion of the piercing the corporate veil area reflects an unusually clear understanding of the nature of the issues involved in that area and deserves quotation at length:

There must be some ground in addition to mere unity of financial interest, ownership, and control for a court to treat them as one in law


87. 554 S.W.2d 712 (Tex. Civ. App.—Dallas 1977, writ ref’d n.r.e.).
and make each responsible for the torts and contracts of the other. That additional ground turns on whether there was good faith and honesty in the use of a subsidiary corporate entity for legitimate ends. Generally, it is determined by whether the subsidiary corporate entity is so controlled and manipulated by the parent for the parent's own interests that it prejudices innocent third parties or is in contravention of the public welfare. The general rule is that courts will not disregard separate legal entities because of identity of ownership, directors and officers unless the purpose of the relationship is to defeat public convenience, protect fraud, defend crime, or justify wrongs, such as violation of anti-trust laws. *Bell Oil & Gas Co. v. Allied Chemical Corp.*, 431 S.W.2d 336, 339 (Tex. 1968).

Much confusion exists in determining the criteria for disregarding the corporate entity. This confusion exists partially because of the words used to describe the condition. Courts have used such terms as 'dummy', 'sham', 'instrumentality', 'agency', 'adjunct', 'tool', 'device', and 'business conduit', to name a few. What these words mean relative to the fact situation of the case is elusive. As Mr. Justice Cardozo, then Associate Judge of the New York Court of Appeals, observed in *Berkey v. Third Ave. Ry. Co.*, 244 N.Y. 84, 155 N.E. 58, 61 (1926):

>The whole problem of the relation between parent and subsidiary corporations is one that is still enveloped in the mists of metaphor. Metaphors in law are to be narrowly watched, for starting as devices to liberate thought, they end often by enslaving it.

The problem as delineated by Justice Cardozo is as troublesome today as then because of the metaphors used by our courts to describe the act or acts necessary to trigger the application of alter ego. Courts have generally been less reluctant to disregard the corporate entity in tort cases than in cases of contract because the injured party in contract cases had the opportunity to select the entity with whom he contracted; in a tort case, no such selection is made by a plaintiff. *Gentry v. Credit Plan Corp. of Houston*, 528 S.W.2d 571, 573 (Tex. 1975). Because Dal-Mac's contract with the subsidiary, Hanson Southwest, is the basis of the claim against the parent, Hanson Development, our further consideration of the alter ego doctrine will be limited to the more stringent standards applied to contracts. In *Bell Oil & Gas Co.*, at 340, Justice Norvell quoted from Douglas and Shanks, *Insulation from Liability Through Subsidiary Corporation*, 39 Yale L.J. 193, 210-11 (1929), the following:

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

Justice Norvell also observed that it is difficult, if not impossible, to put these 'additional compelling facts' in the form of a 'laundry list.' *Bell Oil & Gas Co.* at 340: See 1 Hildebrand, *Texas Corporations* § 5 at 43 (1942). Generally, courts find these 'additional compelling facts' in cases where the plaintiff has acted to his detriment upon representations made by officers of the parent corporation concerning control and ownership of the subsidiary and the payment of its debts.\(^{88}\)

\(^{88}\) *Id.* at 716-18.
Rosenthal v. Leaseway of Texas, Inc.\textsuperscript{89} reflects a much more mechanical approach toward the issue. In a suit involving nonpayment of vehicle lease rentals the court held an individual shareholder, Rosenthal, personally liable on the ground that the corporation, Pollution Solutions, Inc. (Pollution) was an alter ego and a sham corporation. The principal ground for this conclusion was that the articles of incorporation of Pollution had been filed but no organizing steps had been taken: no bylaws adopted; no directors elected; no shares of stock issued; no share certificate or share register created; no meeting of directors or shareholders held; no minute book acquired; no stated capital paid in; and no financial books and records retained. In addition, no franchise taxes were paid to the state nor was a federal income tax return filed. The individual shareholder did, however, serve as president and received aggregate compensation of some $15,000. Nevertheless, when all is said and done, Leaseway did deal with Pollution rather than with Rosenthal individually. The only conceivable justification for the result reached by the court was that personal liability is a kind of punishment for failure to follow the formalities and complete the formation of the corporation.

More sensibly reasoned is Joyner v. Alban Group, Inc.\textsuperscript{90} which was not analyzed as a piercing the corporate veil case, but did involve an incomplete or sloppy organization of a corporation. Two issues were involved: (1) Where a business began transacting business in May 1974 under the name "Alban Group, Inc.," but the corporation with that name was not incorporated until November 1974, may the corporation enforce claims arising from pre-incorporation work? The court's affirmative holding was based in part on an admission by the defendant that the items had been sold to it by "Alban Group, Inc." and in part on the notion that "the cause of action belonged to the Alban Group, Inc."\textsuperscript{91} (2) Where the corporation, Haversack Wine Company, was incorporated in February 1974 and the plaintiff assumed he was dealing with the corporate president on an individual basis, but made no inquiry whether or not a corporation had been formed, may the plaintiff hold the president personally liable by naming him and the corporation as defendants? In holding that the president was not personally liable the court noted that the use of the word "company" is sufficient to charge a person with notice that the business may be incorporated. Apparently the corporate president did not represent or hold himself out as being a partnership or proprietorship.

In each of two other cases decided during the survey period, Norton Refrigerated Express, Inc. v. Ritter Brothers Co.\textsuperscript{92} and L.C.L. Theatres, Inc. v. Columbia Pictures Industries, Inc.\textsuperscript{93} a corporate officer and director was held personally liable, along with the corporation, for fraudulent or tortious conduct because he participated personally in the wrongful conduct.

\textsuperscript{89} 544 S.W.2d 180 (Tex. Civ. App.—Tyler 1976, no writ).
\textsuperscript{90} 541 S.W.2d 292 (Tex. Civ. App.—Houston [1st Dist.] 1976, no writ).
\textsuperscript{91} Id. at 293.
\textsuperscript{92} 552 S.W.2d 910 (Tex. Civ. App.—Texarkana 1977, writ ref’d n.r.e.).
\textsuperscript{93} 421 F. Supp. 1090 (N.D. Tex. 1976).
Finally, in two other cases arising during the survey period, shareholders were not permitted to ignore the existence of their own corporation when it suited their own ends. In *Adams v. Big Three Industries, Inc.* the sole shareholder, employee, officer, and director of a corporation was not permitted to argue that the corporation was only “a piece of paper” so as to avoid the then existing rule that only individual plaintiffs could recover attorney’s fees in certain cases. The court argued that since the shareholder “deliberately chose to operate his business as a corporation,” it “would be inequitable now to allow attorney’s fees as an individual.” In *Evans v. Commissioner* a taxpayer who found it necessary to finance the purchase of an airplane through a corporation in order to take advantage of the more liberal usury rules applicable to corporations, lost the right to take personal deductions for depreciation and losses on resale. There was a substantial business purpose for the corporation which functioned as such, and under such circumstances a long line of cases have held the taxpayer is “stuck” with the corporation. Such a result may usually be avoided simply by the election of subchapter S treatment; the election was apparently available to the shareholder here, but for some reason the election was not made.

**Pooling Agreements and Share Transfer Restrictions.** Two cases during the survey period raise interesting questions about shareholder pooling agreements and restrictions on transfer of shares, both of which are basic components in the close corporation planning arsenal.

*R.H. Sanders Corp. v. Haves* involved the enforceability of a shareholders’ agreement that provided: “Each of the three stockholders shall be a Director of the corporation and each vote shall be equal. A majority of the three-man Board of Directors shall control.” Unfortunately, the agreement did not contain a ten year time limitation, the certificates did not contain a notation that the shares were subject to a voting agreement, and a copy of the agreement had not been deposited at the principal office of the corporation—all apparent requirements for the enforceability of a voting agreement under article 2.30(B) of the Texas Business Corporation Act. The court, however, was not concerned with these “technical” provisions. So far as the time limitation was concerned, the contract was deemed to incorporate the statutory period, the theory being that, “where the contract is silent as to time, the parties presumably contracted with the statute in mind.”

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94. 549 S.W.2d 411 (Tex. Civ. App.—Beaumont 1977, writ ref’d n.r.e.).
96. 549 S.W.2d at 413.
97. 557 F.2d 1095 (5th Cir. 1977).
98. 541 S.W.2d 262 (Tex. Civ. App.—Dallas 1976, no writ).
99. Id. at 262.
101. 541 S.W.2d at 265.
ment.' 102 Here, however, all shareholders were parties and had knowledge of the agreement so that "no compelling policy reason exists . . . for requiring technical compliance . . . ." 103

On the basis of pure common sense this decision has much to commend it. Nevertheless, it is inconsistent with several decisions refusing to uphold voting trusts for noncompliance with analogous provisions. 104 The result, however, is consistent with some prior Texas case law which upheld similar agreements without expressly considering article 2.30(B). 105 All in all, one cannot seriously criticize a case that refuses to invalidate a perfectly reasonable agreement where no one is injured by technical failure to comply with a rather obscure statute.

The share transfer restriction case, Sammons Enterprises, Inc. v. Manley, 106 involved an interesting mechanism for establishing the price at which shares were to be reacquired by a closely held, highly profitable corporation. Sammons Enterprises issued options to purchase shares to two key employees in connection with long term employment contracts. The option price was $320 per share, and each agreement granted the optionee a "put," giving him the right to sell the shares back to the corporation at "fair market value" at any time within twenty years after the exercise of the option. There was no market for the stock. The key paragraphs of the agreement are set forth in the court's opinion:

6.02 Determination of, and payment of Put Price, etc. The Put Price shall be determined by appraisement unless Optionee and the Company acting through its Board of Directors shall agree on the Put Price. Such appraisement shall be based on the decision of the majority of three competent appraisers, two of whom shall be representatives from the Trust Department of the Republic National Bank of Dallas and the First National Bank in Dallas, respectively, and the third shall be an appraiser appointed by the other two appraisers. The Put Price as determined by such appraisement shall be conclusive and binding upon the Company and Optionee. The Put Price (together with accrued interest at the rate of 6% per annum from the date of exercise of the Put) shall be paid by the Company to Optionee within ten (10) days after issuance by the appraisers of their report setting forth the Put Price. All costs and expenses of the appraisement shall be borne by the Company.

Section 6.01(b) of the stock option agreement provided the guidelines for determining the put price as follows:

(b) Put Price. The price which the company shall pay to Optionee upon the exercise of the Put shall be an amount in cash equal to the aggregate fair market value of all the shares subject to the Put which shall be determined as of the last day of the calendar month in which the Put was exercised in accordance with the principles of valuation established for Federal estate tax purposes in valuing stock of a closely-held corporation (including those principles set forth in Section 2031(b) IRC). 107

102. Id.
103. Id.
104. See also Abercrombie v. Davies, 35 Del. Ch. 599, 123 A.2d 893 (1956); Appon v. Belle Isle Corp., 29 Del. Ch. 122, 46 A.2d 749 (1946).
105. 20 R. HAMILTON, supra note 12, § 662.
106. 540 S.W.2d 751 (Tex. Civ. App.—Texarkana 1976, writ ref'd n.r.e.).
107. Id. at 754.
The agreement misfired after the two employees exercised their options, paying over 4.8 million dollars for the shares, and then immediately sought to exercise the put. The parties were unable to agree on a price. The two banks involved refused to make the appraisal unless the employees agreed to provisions that would hold the banks harmless, and indemnify them against possible claims arising from the fact that Sammons Enterprises was a substantial depositor in both banks, its principal shareholder was a director of Republic National Bank, and an officer of Republic was a director of Sammons Enterprises. The employees refused, and matters were stalemated until the employees filed suit.

The issue of the fair market value of the shares was submitted to a jury, which valued each at $457. Even though a jury was certainly not the method of valuation contemplated by the agreement, a judgment based on this figure was affirmed. The court indicated that the appraisal mechanism was not the object of the contract "but only incidental to arriving at the fair market value." The court also stated that the doctrine of impossibility might excuse compliance with the appraisal provision even if it were a condition of the corporation's obligation. Of course, at the time of the suit, the employees had invested significant sums in the shares in complete reliance on the enforceability of the put. To leave them remediless under the circumstances hardly seems fair or just. It further seems hardly fair or just to require them to waive possible claims against the designated appraisers for an improper appraisal as a condition to the exercise of the put. Nevertheless, if parties do not want juries to appraise stock when the designated appraisers fail to do so, it appears to be essential that an alternative, fail-safe appraisal mechanism be established in the agreement itself.

Employment and Authority of Corporate Officers. Three cases during the survey period also raise the perennial question of the inherent authority of officers under Texas law. In Plains Builders, Inc. v. Pride Transport Co., a party who was the corporate president, the chief operating officer, and the principal shareholder executed a non-negotiable promissory note with the signature "Stanley D. Wardlaw, President—Wardlaw Transport Express." The corporation sought to avoid payment on the ground of lack of authority. There was no evidence of approval by the directors, but the court held the corporation bound because as "Chief operating officer," Wardlaw was the equivalent of a "general manager," with broad power to bind the corporation.

In Sabine Investment Co. of Texas, Inc. v. Stratton, an agent for a real estate firm was found to have implied authority to enter into an executory contract to sell a lot owned by the firm. The court did not specify whether the authority was actual or apparent, but relied on evidence that could lead

108. Id. at 756.
109. See 20 R. HAMILTON, supra note 12, § 585.
111. Id. at 60; see, e.g., Sealy Oil Mill & Mfg. Co. v. Bishop Mfg. Co., 235 S.W. 850 (Tex. Comm'n App. 1921, judgm't adopted). As indicated in my treatise, this is only one of three possible lines of authority available in Texas. 20 R. HAMILTON, supra note 12, § 585.
to either: business cards for the agent which were supplied by the defendant, a desk in defendant’s offices, the availability of the defendant’s plats and maps, and the like. In this context the court made it clear that it was only considering a corporation that was engaged in the business of buying and selling real estate. Ultimately the corporation prevailed on an independent ground: the contract was not complete and did not satisfy the statute of frauds.

The third case, Templeton v. Nocona Hills Owners Association,113 indicates that the doctrine of extremely limited authority for corporate presidents in Texas is alive and healthy. The contract involved the employment of a manager of a country club for one year with a base compensation of $850 per month. The agreement was executed by the club president but never approved by its board of directors. The court held the agreement unenforceable, stating that “the settled rule in Texas is that a corporation president, merely by virtue of his office, has no inherent power to bind the corporation except as to routine matters arising in the ordinary course of business.”114

Pioneer Specialties, Inc. v. Nelson115 is a rather peculiar 1960 Texas Supreme Court opinion relating to employment contracts for corporate officers. The essence of the holding of that case is that where a bylaw provides that an officer shall be elected annually, an employment contract to serve in that office may not exceed one year.116 In Meredith v. Duval County Ranch Co.117 a court refused to expand the principle of Pioneer Specialties. The contract appointed a person chairman of the board of directors “until further action of the Board of Directors” and provided for long term compensation for himself and his wife (in the event his salary was reduced). The court held that this did not violate public policy as set forth in Pioneer Specialties since the contract provided for additional duties for the employee other than serving as chairman of the board. The court also concluded that long-term employment contracts are generally valid and that the claimed disparity in exchanged considerations was not so unconscionable as to merit equitable relief.118

Venue and Jurisdiction. Most cases involving issues of venue and jurisdiction are not particularly survey-worthy, because they involve straightforward application of the venue and long-arm statutes to various fact patterns. At least one case, however, is of indirect interest to most Texas attorneys. The United States Supreme Court has struck down the so-called Delaware sequestration statute which attempted to divert most litigation involving the

114. Id. at 538.
115. 339 S.W.2d 199 (Tex. 1960).
116. The case is discussed in 20 R. HAMILTON, supra note 12, § 591. It would appear that, whatever the nature of this principle, it should not apply when the board has the power to amend the bylaws. In that event the directors might amend the bylaws to provide for longer election periods and it exalts form over substance to require the two-step procedure of amending and then contracting. An implied amendment of the bylaws raises practical problems of its own, however, since the written bylaws cannot safely be relied upon.
118. Id. at 265.
internal affairs of corporations under Delaware law into the Delaware courts. The case involves a significant revision of constitutional concepts of "quasi in rem" jurisdiction.

**Ultra Vires Guarantees of Indebtedness.** Article XII, section 6 of the Texas Constitution provides that no corporation shall issue "stock or bonds except for money paid, labor done, or property actually received." The precise scope of this article and its potential application to corporate guarantees of indebtedness has always been uncertain. During the survey period the Fifth Circuit rejected an argument put forward in a bankruptcy case that a corporation's written guarantee of the indebtedness of another constituted a stock or bond and, therefore, was unenforceable as a violation of article XII, section 6. The court relied primarily on the historical evil against which section 6 was directed—watered stock. It also pointed out, however, the broad consequences of accepting the constitutional argument, which would make impossible the assumption of an obligation for future benefits and would invalidate a Texas statute permitting corporate guarantees of indebtedness that had been amended two times during the 1970's.

**De facto Mergers.** In *Western Resources Life Insurance Co. v. Gerhardt* the court adopted the concept of a de facto merger to hold Western Resources Life Insurance Company (WR Life) liable for tort obligations, including exemplary damages, incurred by American Business and Commercial Life Insurance Company (ABC). WR Life had acquired the assets of ABC in exchange for shares of WR Corporation, apparently either the parent of WR Life or a close affiliate. ABC distributed the shares to its shareholders and then dissolved. The agreement stated that WR Life was not assuming contingent liabilities of ABC, including presumably the fraud claims of the plaintiffs. The board of directors of WR Life was increased, however, from nine to fifteen, with the six new directors being designated by ABC, so that considerable continuity existed.

In a brief opinion the court held "that an overview of the entire transaction has convinced us that the effect was a merger of the two corporations." While the court stressed the continuation of the business, it also relied "upon the notion that no corporation should be permitted to commit a tort and avoid liability through corporate transformations or changes in form only." Finally, it distinguished between transactions in which the purchasing corporation paid for assets with stock, which is usually considered a

120. TEX. CONST. art. XII, § 6.
121. H.J. Cohn Furniture (No. 2) Co. v. Texas W. Furniture Corp., 544 F.2d 886 (5th Cir. 1977).
122. The statute referred to, of course, is TEX. REV. CIV. STAT. ANN. art. 1302-2.06B (Vernon Supp. 1978), relating to corporate guarantees. This statute was amended in 1973 and 1977. *Id.*
123. 553 S.W.2d 783 (Tex. Civ. App.—Austin 1977, application for writ pending).
124. *Id.* at 786.
125. *Id.*
de facto merger, and transactions in which the assets are paid for with cash, which is generally considered to be a bona fide sale of assets without tort liability following the purchasing corporation. A writ of error is pending. While the opinion seems to oversimplify a complex area and to assume pat answers based on simple criteria, the conclusion seems reasonable on the specific facts.

Securities Regulation. At the federal level, the survey period has seen further attempts by the United States Supreme Court to narrow and restrict the role of the federal courts. In TSC Industries, Inc. v. Northway, Inc., for example, the Court narrowed the test of materiality in determining whether misstatements or omissions in proxy statements may be used to attack a transaction approved as a result of the proxy solicitation. The Court stated that a material fact was one that a reasonable shareholder would consider important in deciding how to vote. Earlier case law, particularly Mills v. Electric Auto-Lite Corp., had somewhat ambiguously indicated that the test should be whether such a shareholder might consider the fact important.

Other significant cases included: Ernst & Ernst v. Hochfelder, holding that scienter is an essential element of private causes of action under rule 10b-5; Piper v. Chris-Craft Industries, Inc., holding that a defeated cash tender offeror does not have standing to bring a private damage suit under the so-called Williams Act; and Santa Fe Industries, Inc. v. Green, refusing to permit rule 10b-5 to be used to attack an allegedly unfair “going private” transaction. These cases were decided so recently that their full implications are still uncertain. The lower and state courts are beginning to struggle with these cases with divergent results. In Dupuy v. Dupuy, for example, the Fifth Circuit considered the effect of the Hochfelder scienter requirement on the issue of the standard of care required of the plaintiff. The court concluded that the test should not be whether the plaintiff acted “unreasonably,” but whether he intentionally refused to investigate in light of a known risk or a risk so obvious that he must have been aware of it. Mr. Justice White of the United States Supreme Court dissented from the denial of certiorari in this case, arguing that the disagreement among the circuits on this issue required Supreme Court action: “Business can be transacted more freely and efficiently if the responsibility for verifying facts is clearly allocated.”

In another interesting development, the Supreme Court of Delaware has indicated that it will broaden Delaware law to fill the gap left by the United States Supreme Court in Santa Fe. In Singer v. Magnovox Co., the court

126. Id. at 787.
132. 551 F.2d 1005 (5th Cir. 1977), cert. denied, 98 S. Ct. 312, 54 L. Ed. 2d 197 (1977).
133. 98 S. Ct. 312, 54 L. Ed. 2d 197 (1977).
134. Id. at 313, 54 L. Ed. 2d at 198.
135. 367 A.2d 1349 (Del. 1977).
held that a short form merger must have not only a valid business purpose but also must meet the test of "entire fairness." Tanzer v. International General Industries, Inc.\textsuperscript{136} concluded that a legitimate business purpose existed when the principal reason for the cash merger, eliminating the minority interest, was a desire to facilitate long term debt financing by the parent corporation. Of course, the test of "entire fairness" would also have to be met. Lynch v. Vickers Energy Corp.\textsuperscript{137} saw the Delaware Supreme Court employ a standard of full disclosure in a cash tender offer, as a matter of state law, that appears to rival the approach taken by lower federal courts under the federal securities laws prior to Chris-Craft. While it is possible that the Delaware corporate bar will choke off the rather expansionist views of the Delaware Supreme Court by legislative amendment, the development may reflect a wholesome, permanent restoration of the balance between the federal and state jurisdiction in the corporation law area.

\textsuperscript{136} 379 A.2d 1121 (Del. 1977).
\textsuperscript{137} 351 A.2d 570 (Del. 1976).