Corporations and Partnerships

Robert W. Hamilton

Recommended Citation
https://scholar.smu.edu/smulr/vol36/iss1/9

This Article is brought to you for free and open access by the Law Journals at SMU Scholar. It has been accepted for inclusion in SMU Law Review by an authorized administrator of SMU Scholar. For more information, please visit http://digitalrepository.smu.edu.
The survey period of 1981 witnessed a number of legislative changes and judicial decisions affecting the law of corporations and partnerships. While it would be an overstatement to call these changes major or fundamental, many of the developments are important to legal practitioners since they affect broad areas of business practice or provide clear answers to problems that formerly were viewed as open or uncertain.

I. LEGISLATIVE CHANGES

In 1981 the Texas Legislature made a large number of changes in the statutes relating to corporations. The most important of these changes is the complete revision of the close corporation statute. Many other changes affecting routine incorporations, bylaw provisions, and corporate actions will have an impact upon the traditional work product of the practitioner, and every attorney should review carefully the forms currently used in light of these recent amendments.

A. The 1981 Texas Close Corporation Statute

In 1973, following the lead of several other states, Texas enacted a special statute tailored to the perceived problems of closely held corporations. The legislative changes of significant import are discussed in this survey article. For additional changes of general interest, see Tex. Rev. Civ. Stat. Ann. art. 581—5 (Vernon Supp. 1982) (exemptions in the Texas Securities Act relating to the sale and issuance of securities of mutual loan corporations, farmers' cooperative associations, and farmers' cooperative societies); id. art. 1302—2.09A (establishing alternative maximum interest rates for corporations based on the bank discount auction average rate for 26-week treasury bills or the annual or quarterly ceilings published by the Consumer Credit Commission subject to a ceiling of 24% (28% if the borrowing is for business, commercial, investment or similar purposes and exceeds $250,000)); id. art. 342—407 (deleting former requirement that directors of state bank be shareholders); id. arts. 5069—16.01 to 5069—16.15 (adoption of systemic plan of regulation of the sale, lease or transfer of “business opportunities,” defined to include the sale or lease of products, equipment, supplies or services in excess of $500 if the seller helps provide a location, marketing program or agrees to buy back unsold products); Tex. Bus. & Com. Code Ann. § 36.15 (Vernon Supp. 1982) (establishing revised fees for county clerks and the secretary of state for indexing names on assumed business or professional name certificates); id. § 17.42 (a “consumer,” which includes corporations or partnerships purchasing or leasing goods or services, with assets of $25,000,000 or more may waive in writing the protections of the Deceptive Trade Practices-Consumer Protection Act).  

operating under the regular business corporation act. Problems of coordination with other portions of the Texas Business Corporation Act (TBCA) arose almost immediately, however, and in 1975 the legislature completely revised the close corporation statute.\(^3\) The failure to use the 1975 statute, in turn, was not so much because of its impracticability but rather because it was formidable, complex, and verbose.\(^4\) The 1981 version of the close corporation statute is in every respect a new model. The statute repealed the old articles 2.30-1 through 2.30-5,\(^5\) and replaced them with a new chapter in the Texas Business Corporation Act, part twelve, entitled the "Texas Close Corporation Law."\(^6\) Further, most of the complexity and verbosity of the 1975 legislation has disappeared: articles are shorter and interspersed with titled subheadings, and much of the old version's needless spinning out of scenarios has disappeared.

In addition, the new part twelve contains provisions that should be powerful inducements for attorneys to use the new Texas Close Corporation Law on a regular basis. The principal spur in this regard may be a relatively modest and buried provision, article 12.37(F)(1),\(^7\) which attempts to reverse by statute a substantial body of the traditional case law relating to the doctrine of piercing the corporate veil or alter ego. Under this article, the failure of an electing close corporation "to observe usual formalities or requirements prescribed for an ordinary corporation" shall not be a factor in determining whether to impose personal liability on the shareholders for the close corporation's obligations by disregarding the separate entity of the close corporation or otherwise.\(^8\) This appears to be broader than the language in other statutes from which it was derived.\(^9\) Every attorney forming a small corporation is aware that the piercing of the corporate veil or alter ego doctrines may lead to the imposition of personal shareholder liability for corporate obligations. A major factor courts consider in the

---

4. See Blunk, Analyzing Texas Articles of Incorporation: Is the Statutory Close Corporation Format Viable?, 34 Sw. L.J. 941 (1980). This study concluded that even though most corporations formed in Texas possessed a majority of the characteristics of a close corporation, only a small fraction of eligible corporations (five percent or less) elected close corporation status. Id. at 960. Studies in other states tend to confirm this conclusion. See Karjala, A Second Look at Special Close Corporation Legislation, 58 Texas L. Rev. 1207, 1266 n.236 (1980).
7. Id. art. 12.37(F)(1). This section also provides that failure to follow formalities or the requirements applicable to ordinary corporations does not invalidate a shareholders' agreement or the status of the corporation as a close corporation. Id. art. 12.37(F)(2) & (3).
8. Id. art. 12.37(F)(1).
9. See ABA-ALI Model Bus. Corp. Act: Proposed Stat. Close Corp. Supp. § 17 (1980), reprinted in, 37 Bus. Law. 269, 306 (1981), which provides that failure to follow corporate formalities "shall not be grounds for imposing personal liability on the shareholders . . . ." The comment to this section, however, states that it "would not prevent a court from piercing the corporate veil of a statutory close corporation if the circumstances would justify imposing personal liability on the shareholders had the corporation not been a statutory close corporation. It merely prevents a court from piercing the corporate veil because it is a statutory close corporation." Id. at 306-07.
imposition of such liability, though not in Texas as much as elsewhere, is the extent to which the corporation followed corporate formalities in its day-to-day operations. As a result, the traditional advice of cautious attorneys to their clients in this area is to adhere to corporate formalities. As a practical matter, however, this advice often was not heeded as the shareholders struggled to operate their business on a daily basis. Under the new article 12.37(F) much of the concern about unexpected liability in this area apparently can be eliminated simply by taking advantage of the new close corporation election.

Election and Termination of Close Corporation Status. The new Texas Close Corporation Law does not impose numerical limitations on the number of shareholders that may participate in an electing close corporation. Any corporation desiring to take advantage of part twelve may elect close corporation status simply by placing in its articles of incorporation the following statement: "This corporation is a close corporation." The statement may also be added by amendment to the articles of an existing corporation or by way of a merger or consolidation. Further, a corporation that elected close corporation status under the 1975 statute is automatically an electing close corporation under the new part twelve.

The Texas Close Corporation Act also requires a conspicuous notation on the certificate representing shares of the corporation that reads:

These shares are issued by a close corporation as defined by the Texas Business Corporation Act. Under that Act, a shareholders' agreement may provide for management of a close corporation by the shareholders or in other ways different from an ordinary corporation.

10. See notes 109-47 infra and accompanying text for a discussion of recent Texas cases involving the piercing the corporate veil doctrine.

11. Some doubt always exists about the efficacy of a general statute such as art. 12.37(F)(1) in the light of the numerous contexts in which courts apply the piercing the corporate veil doctrine. Even if this article is construed narrowly rather than broadly, however, it should give some protection against the imposition of liability for corporate obligations on individual shareholders, an area that is now clouded with uncertainty. See 19 R. HAMILTON, BUSINESS ORGANIZATIONS, § 234 (Texas Practice 1973).

In his description of article 12.37(F) upon its proposal by the Texas Bar Association, Professor Lebowitz wrote that the failure to adhere to normal corporate norms "should not be regarded as factors per se to warrant disregard of the corporate entity . . . ." Lebowitz, Texas Close Corporation Law, 44 TEx. B.J. 51, 54 (1981) (emphasis added). If anything, this description lessens the protection of article 12.37(F) against personal liability for corporate obligations and realigns it with the statutory antecedents of the statute discussed in note 9 supra.

12. TEx. BUS. CORP. ACT ANN. arts. 12.01-.54 (Vernon Supp. 1982).

13. Id. art. 12.11.

14. Id. art. 12.13(A). Such an amendment must be approved by all the shareholders whether or not otherwise entitled to vote.

15. Id. art. 12.13(B). Such a merger must be approved by all the shareholders of both the surviving and disappearing corporations whether or not otherwise entitled to vote.

16. Id. art. 12.14. All provisions in the articles of incorporation of such a corporation that were required under the old close corporation statute remain valid and enforceable so long as its close corporate election is retained under the new statute. Id. A shareholders' agreement under the old statute is also treated as a shareholders' agreement under articles 12.32-12.37 of the new act.
This may subject the holder of this certificate to certain obligations and liabilities not otherwise imposed on shareholders of an ordinary corporation. On any sale or transfer of these shares, the transferor is obligated to deliver to the transferee a complete copy of any shareholders' agreement.\textsuperscript{17} The omission of this statement, however, does not affect the validity of the close corporation election.\textsuperscript{18}

The termination of a close corporation election is somewhat more complex than the original election, principally because the terminating corporation must restore itself to the status of an ordinary corporation.\textsuperscript{19} If the corporation has operated without a board, one must be selected in the manner specified in either the statute or the operative shareholders' agreement.\textsuperscript{20} These provisions are drafted clearly, and provide a sensible procedure by which a close corporation may return to the status of an ordinary corporation.\textsuperscript{21}

Privileges Resulting From the Election of Close Corporation Status. The basic privilege that a close corporation election provides is the corporation's ability to operate under a shareholders' agreement with essentially as much freedom as a partnership but without the concern of personal or unlimited liability. The shareholders' agreement may cover any one or more of an elaborate list of topics, including dispensation with a board of directors, the imposition of any type of restrictions on transfer of shares or the restriction of the right to participate in management by transferees, and the right of dissolution by one or more shareholders upon the occurrence of a specified event or contingency.\textsuperscript{22} The validity of this agreement is in no way dependent upon its conformity with traditional corporate norms.\textsuperscript{23}

The Shareholder Agreement. The shareholder's agreement is the basic close corporation document. It must be executed by every voting and non-

\textsuperscript{17} Id. art. 12.39(A).
\textsuperscript{18} Id. art. 12.39(B).
\textsuperscript{19} Termination may be effected by deletion of the "magic" close corporation election statement from the articles or by filing a "statement of termination" with the secretary of state. \textit{Id.} art. 12.21(A). The draftsmen apparently contemplate that the latter method will normally be followed, since article 12.22 contains elaborate provisions for the contents of the statement, its filing, the effect of the filing, and for notifying shareholders that the statement of termination has been filed. \textit{Id.} art. 12.22(B)-(E).

Consistent with the general approach of the chapter, article 12.37(F)(3) provides that the failure to follow corporate formalities or the traditional rules applicable to ordinary corporations does not affect the validity or continuation of a close corporation election.

\textsuperscript{20} Id. art. 12.23(C), (D).
\textsuperscript{21} Interim directors named in the shareholders' agreement may manage the business, \textit{id.} art. 12.23(C)(1), or if none are named, the shareholders may manage the business in the interim. \textit{Id.} art. 12.23(E). Permanent directors are to be elected at a shareholders' meeting, however, which may be called by any single shareholder if such a meeting is not held within 30 days after the termination became effective. \textit{Id.} art. 12.23(D). The number of directors to be elected may be specified in the articles or bylaws, or if not, the number is three and they shall serve until the next annual shareholders' meeting. \textit{Id.} art. 12.23(D)-(E).

\textsuperscript{22} Id. art. 12.32(A).
\textsuperscript{23} Id. art. 12.37(F)(2).
voting shareholder of an existing corporation that is electing close corporation status and by every person who has subscribed for the shares of or is to become a shareholder of a new close corporation.24 Copies of this basic document must be made available to all persons bound by the agreement and to every person issued a certificate representing shares.25 The agreement, however, need not be made a matter of public record. The statute contemplates only the filing with the secretary of state of a document entitled, “Statement of Operation as a Close Corporation,” which recites that the close corporation “is being operated and its business and affairs are being conducted under the terms of a shareholders agreement made pursuant to the Texas Close Corporation Law” and specifying when the date of operation began.26 This filing makes the corporation’s operation as a close corporation a matter of public record, but the failure to file it does not apparently affect the validity of the agreement or the status of the corporation.27

The Texas Close Corporation Law makes it clear that a transferee, donee, purchaser, or legatee takes shares subject to the terms of the shareholders’ agreement “for all purposes” regardless of whether such transferee had knowledge of the existence of the agreement.28 While a transferor is required by statute to provide a transferee with a copy of the agreement,29 the validity or enforceability of the agreement and the interest of the transferee in the shares are not affected by a failure to do so.30 Such a transferee is entitled only to the rather bitter right to obtain a copy of the agreement to which he is unknowingly subject.31 Conversely, a person who disposes of his shares generally is not subject thereafter to the restrictions of the agreement.32 This provision, of course, does not apply to dispositions that are themselves violations of the agreement and does not relieve a person of liability for predisposition breaches.

A shareholders’ agreement may be modified only by the written consent of all voting and nonvoting shareholders or subscribers33 and is terminated when the close corporation election is terminated.34 The agreement, however, may provide that it remains in effect as an ordinary shareholders’ agreement.35

24. Id. art. 12.33(A). The shareholders’ agreement may serve as combination subscription agreement, agreement to become a shareholder, and governing document for the corporation.
25. Id. art. 12.33(C).
26. Id. art. 12.34(B).
27. Id. art. 12.34(D).
28. Id. art. 12.36(A).
29. Id. art. 12.36(B).
30. Id.
31. Id.
32. Id. art. 12.36(D).
33. Id. art. 12.33(B).
34. Id. art. 12.36(E).
35. Id. Presumably this exception means that the agreement is subject to the limitations on pooling agreement pursuant to the Texas Business Corporation Act. See id. art. 2.30(B) (Vernon 1980).
The Role of Shareholders in the Electing Close Corporation. If the shareholders' agreement dispenses with the board of directors, the shareholders are deemed to be directors for purposes of most other provisions of the close corporation act. This includes liability for managerial acts or omissions, and may include liability for acts taken by third persons empowered with management authority by the shareholders' agreement, apparently on the theory that the shareholders should accept responsibility for their failure to oversee the conduct of those third persons. A shareholder is not liable, however, unless he had the right to vote or to consent to the action taken, and he is also insulated from liability if he dissents from the action taken.

Shareholders may take director-type actions by a majority vote without a meeting if authorized by the shareholder agreement, and they may also take informal action by unanimous consent without a meeting and without a written consent if the action is taken with "the full knowledge of the action by all the shareholders of the close corporation and their failure to object to the action in a timely manner." This article appears to be drafted rather narrowly, however, and some actions, if not taken by unanimous consent, may require a formal meeting and approval by a majority of all outstanding shares in contrast to the traditional requirement of a majority of the shares voting at a meeting at which a quorum is present. Whether such a result is desirable is questionable, but in any event the impact of the statute may be changed by appropriate provisions in the shareholders' agreement.

Judicial Proceedings Relating to Close Corporations. The Texas Close Corporation Law contains provisions specifically authorizing three types of judicial proceedings: (1) enforcement of a close corporation provision,
(2) appointment of a provisional director, and (3) appointment of a custodian. This listing of judicial remedies is not exclusive, however, and therefore does not foreclose institution of other types of litigation.

(a) Preconditions to Suit. Generally a shareholder must exhaust remedies under the close corporation agreement before he may resort to any judicial remedy. Arbitration is specifically referred to as an example of a nonjudicial remedy. Further, a shareholder may not commence a proceeding for damages or monetary relief if he has an appraisal remedy under the shareholders' agreement or under other statutory provisions. This provision, however, does not seek to exclude equitable or other relief because of the appraisal remedy. The general requirement of exhaustion of remedies is not applicable if the shareholder "proves that the close corporation, the shareholders as a whole, or the shareholder will suffer irreparable harm before the nonjudicial remedy is exhausted."

(b) Proceedings to Enforce Close Corporation Provisions. Article 12.52 authorizes a court of "competent jurisdiction," to enforce specifically a close corporation provision "without regard to whether or not there is an adequate remedy at law," in a manner the court determines to be "fair and equitable." The statute then adds a list of nonexclusive possible remedies, including damages rather than specific performance, appointment of a provisional director or custodian, appointment of a receiver for specific assets or to rehabilitate the corporation, involuntary dissolution, or termination of the close corporation status. In general terms, the remedies of liquidation, involuntary dissolution, and receivership are available only if the court determines that all other remedies are "inadequate."

(c) Provisional Directors. A provisional director may be appointed for a close corporation if the directors or persons authorized to manage the business are in such discord respecting the management of the corporation's

43. Id. art. 12.51(B).
44. Id. art. 12.51(D).
45. Id. art. 12.51(E).
46. Id.
47. Id. See arts. 5.11-5.13 (Vernon 1980).
48. Id. art. 12.51(E).
49. Id. This simple test gives courts ample freedom to consider what kinds of injury are "irreparable" because no further explanation of the term is provided.
50. Id. art. 12.51(A)(1). A court of "competent jurisdiction" refers to a district court in the county in which the close corporation has its principal office.
51. Id. art. 12.52(A).
52. Id. art. 12.52(A)(1).
53. Id. art. 12.52(A)(2).
54. Id. art. 12.52(A)(3). This article must comply with id. art. 7.04 (Vernon 1980).
55. Id. art. 12.52(A)(4).
56. Id. art. 12.52(A)(6). The statute mandates that termination is not to be decreed except in the most dire circumstances. The court must first determine that all other remedies are inadequate, and that factors relating to the size, business, and shareholder relationships of the corporation "make it wholly impractical to continue close corporation status." Id.
57. Id. art. 12.52(B).
affairs that the inability to obtain the votes or consent required for corporate action precludes handling of the close corporation’s affairs to the general advantage of the shareholders.\textsuperscript{58} If the shareholders’ agreement dispenses with the board and vests management in the shareholders, a “provisional director” may be appointed to vote as a shareholder in connection with the management of the business.\textsuperscript{59}

A provisional director must be an “impartial person” who has had no prior formal connection with the corporation, as shareholder, party to a shareholders’ agreement, manager or creditor.\textsuperscript{60} He or she has all the rights and powers of a director or manager pursuant to a shareholders’ agreement\textsuperscript{61} and is entitled to compensation for services rendered.\textsuperscript{62} The amount may be set by agreement with the corporation with court approval, or by the court alone if agreement cannot be reached.\textsuperscript{63} A provisional director may be removed by a vote of a majority of the regular directors or the shareholders or such other percentage as may be necessary to take action under the shareholders’ agreement.\textsuperscript{64} The theory of the provision is that director or shareholder agreement to act on his or her removal obviates any need for the provisional director.

(d) Custodians. A custodian for a close corporation must have essentially the same qualifications as a receiver appointed under other provisions of the TBCA,\textsuperscript{65} and has essentially the same duties and responsibilities except that his objective is to continue the business of the corporation rather than to liquidate it.\textsuperscript{66} A custodian may be appointed for a close corporation in three situations: (1) the shareholders are so divided that they have failed to elect successors to directors whose terms have expired; (2) the business of the corporation is suffering or is threatened with “irreparable injury” because the directors, shareholders, or persons with authority to manage the business under a shareholders’ agreement are so divided that action cannot be taken, and other deadlock remedies have failed, or (3) the plaintiff has the right to dissolve the close corporation under a shareholders’ agreement.\textsuperscript{67}

\textsuperscript{58} Id. art. 12.53(A).
\textsuperscript{59} Id. art. 12.53(B)(2).
\textsuperscript{60} Id. art. 12.53(B)(1).
\textsuperscript{61} Id. art. 12.53(B)(2). Such rights include a right to notice of, and power to vote at meetings of directors or shareholders. Id.
\textsuperscript{62} Id. art. 12.53(B)(4).
\textsuperscript{63} Id.
\textsuperscript{64} Id. art. 12.53(B)(3).
\textsuperscript{65} Id. art. 12.54(B). The qualifications, powers, and duties of a receiver are set forth in id. arts. 7.05-7.07. These articles are made expressly applicable to custodians by art. 12.54(B).
\textsuperscript{66} Id. art. 12.54(B). The appointment of a custodian specifically to carry out a dissolution pursuant to an express power to dissolve in a shareholders’ agreement clearly is the exception to the continuation objective. Id.
\textsuperscript{67} Id. art. 12.54(A).
B. Protection of Greater Voting Requirements for Shareholders

Article 9.08(A) of the TBCA has long permitted the articles of incorporation to increase the number of shares needed to approve a corporate action by shareholders up to and including unanimity. In 1981 this article was amended to require that any amendment or modification of such a supermajority provision be approved by the vote required by the provision itself. In effect, this new section prevents the removal of a supermajority requirement contained in the articles of incorporation by the simple two-thirds vote generally required for amendments to the articles. This provision apparently was designed to protect a minority shareholder's veto power in a close corporation. The article also may encourage the use of a supermajority requirement in publicly held corporations as a device to thwart hostile takeovers.

C. Correction of Filings with the Secretary of State

In 1981, a new part seven was added to the Texas Miscellaneous Corporation Laws Act to permit “corrections” in documents filed with the secretary of state. A “correction” may be made (1) if the instrument filed is an inaccurate record of the corporate action referred to in the instrument, (2) if the instrument contains “an inaccurate or erroneous statement,” or (3) if the instrument “was defectively or erroneously executed, sealed, acknowledged, or verified.” A correction is made by filing a simple “Articles of Correction” form and paying the filing fee of ten dollars. The secretary of state's subsequent issuance of a “Certificate of Correction” follows the traditional pattern of handling corporate documents in Texas.

In practice, the correction of filed documents may turn out to be a slippery business because the provision is not limited to mechanical or factual errors at the time the document was filed, but apparently may include corrections necessitated by subsequent events. Article 1302—7.04 attempts to deal with such problems by stating that although the instrument as corrected is considered to have been filed on the date the original instrument was filed, “as to persons who are adversely affected by the correction, the instrument as corrected is considered to have been filed on the date the articles of correction were filed.” While a need may exist for a mechanism to obviate the formal amendment process in correcting clerical or other inadvertent errors on documents filed with the secretary of state,

68. Id. art. 9.08(A) (Vernon 1980).
69. Id. art. 9.08(B) (Vernon Supp. 1982).
70. Id. art. 4.02 (Vernon 1980).
71. TEX. REV. CIV. STAT. ANN. arts. 1302—7.01 to 1302—7.05 (Vernon Supp. 1982).
72. Id. art. 1302—1.01 to 1302—7.05.
73. Id. art. 1302—7.01.
74. Id. art. 1302—7.03.
75. Id. art. 1302—7.05.
76. Id. art. 1302—7.03.
77. Id. art. 1302—7.04(B).
only time will tell whether this new chapter creates more problems than it solves.

D. Amendments of Articles and Other Corporate Actions Before Shares are Issued

Before shares are issued, the initial board of directors may approve necessary amendments to the articles of incorporation by its own majority vote. A minor amendment to article 4.04 of the TBCA provides that the secretary of state may accept articles of amendment in this situation if executed and verified by a majority of the directors.

E. Combination of Offices of President and Secretary

Persons forming one-person corporations in Texas have long questioned the logic behind article 2.42 of the TBCA that required the offices of president and secretary to be held by different persons. In effect, this provision required one incorporated proprietor to have a financially disinterested outsider serve as an officer of the corporation. This requirement was eliminated in 1981 so that now “[a]ny two (2) or more offices may be held by the same person.”

F. Corporate Purposes

Part four of the Texas Miscellaneous Corporation Laws Act, a set of anachronistic provisions relating to the acquisition and ownership of land by business corporations, was finally repealed in 1981. For many years this part had virtually no substantive impact but served primarily as a trap for unwary or newly admitted attorneys who included a reference to the acquisition of real estate in the articles of incorporation but failed to add the magic phrase, “Subject to Part Four of the Texas Miscellaneous Corporation Laws Act.”

Another minor change was made in 1981 in article 2.01, a corporate purpose provision that also authorizes certain natural resource corporations to exercise the power of eminent domain under the Natural Resources Code. The amendment extended the power of eminent domain to a corporation or groups of corporations acting in partnership or in com-

---

78. TEX. BUS. CORP. ACT ANN. art. 4.02(A)(1) (Vernon 1980).
79. Id. art. 4.04(A) (Vernon Supp. 1982).
80. TEX. BUS. CORP. ACT ANN. art. 2.42(A) (Vernon Supp. 1982).
83. This requirement was stripped of all meaning when the TBCA was amended in 1973 to permit a corporate purpose to engage in any lawful business. TEX. BUS. CORP. ACT ANN. art. 3.02 (Vernon 1980). Indeed, this author is advised that references to real estate in articles of incorporation had become so infrequent in recent years that the secretary of state had stopped rejecting articles of incorporation for failing to include the “magic phrase” referred to in the text.
84. TEX. BUS. CORP. ACT ANN. art. 2.01(B)(3)(b) (Vernon Supp. 1982) incorporating TEX. NAT. RES. CODE ANN. §§ 111.019-022 (Vernon 1978). The double nature of this article is discussed in R. HAMILTON, supra note 11, at § 355.
bination with other corporations and also to corporations engaged in the transportation of carbon dioxide as well as other minerals.\footnote{85}{TEX. BUS. CORP. ACT ANN. art. 2.01(3)(b) (Vernon Supp. 1982).}

\section*{G. Foreign Corporations}

A number of technical amendments to the filing requirements applicable to profit and nonprofit foreign corporations were made in 1981.\footnote{86}{TEX. REV. CIV. STAT. ANN. art. 1396–4.06 to 1396–9.03 (Vernon Supp. 1982).} These amendments not only brought the provisions relating to foreign nonprofit corporations into line with correlative principles applicable to corporations for profit, but also made many technical changes in the TBCA. These changes are not of a type that need to be described in detail in an annual survey. Attorneys representing foreign corporations will find it important to review this legislation, and to make the necessary technical changes to assure that future filings are consistent with the new requirements.

\section*{H. Nonpayment of Filing Fees or Initial Franchise Tax Deposits}

Apparently in order to combat “hot checks” received by the secretary of state for filing fees or franchise tax deposits, the Texas statutes were amended in 1981 to permit involuntary dissolution of domestic corporations, revocation of certificates of authority of foreign corporations, or revocation of the filing of any document, if the filing fee was not paid or “was paid by an instrument that was dishonored when presented by the state for payment.”\footnote{87}{TEX. BUS. CORP. ACT ANN. art. 7.01(B)(3) (Vernon Supp. 1982) (involuntary dissolution); \textit{id.} art. 8.16(B) (Vernon Supp. 1982) (revocation of certificate of authority of foreign corporation); TEX. REV. CIV. STAT. ANN. art. 3916B (Vernon Supp. 1982).} Notice of a dishonored check and subsequent dissolution or revocation may be given by regular mail.\footnote{88}{TEX. BUS. CORP. ACT ANN. arts. 7.01C(2), 8.16C(2). The failure to give this notice does not affect the validity of the dissolution or revocation. \textit{id.}}

\section*{I. Acknowledgments}

In a stride toward simplicity, the 1981 legislature authorized a short form of acknowledgment for individuals, corporations, partners, and various types of representatives.\footnote{89}{TEX. REV. CIV. STAT. ANN. art. 6607a, \S\ 2(1).} The form basically requires only the statement, “This instrument was acknowledged before me on [date] by [name or names of person or persons acknowledging]” followed by a simple notarial execution.\footnote{90}{\textit{id.} art. 6607a \S\ 3 (Vernon Supp. 1982). The statute does not pertain to corporate documents that have to be verified.} The term “was acknowledged” in this form is statutorily defined to include personal appearance before the notarial official and acknowledgment that he or she executed the document “for the purposes and consideration expressed in the instrument.”\footnote{91}{\textit{id.} art. 6607a \S\ 2(1).}

\begin{thebibliography}{99}
\item 85. TEX. BUS. CORP. ACT ANN. art. 2.01(3)(b) (Vernon Supp. 1982).
\item 86. TEX. REV. CIV. STAT. ANN. art. 1396–4.06 to 1396–9.03 (Vernon Supp. 1982).
\item 87. TEX. BUS. CORP. ACT ANN. art. 7.01(B)(3) (Vernon Supp. 1982) (involuntary dissolution); \textit{id.} art. 8.16(B) (Vernon Supp. 1982) (revocation of certificate of authority of foreign corporation); TEX. REV. CIV. STAT. ANN. art. 3916B (Vernon Supp. 1982).
\item 88. TEX. BUS. CORP. ACT ANN. arts. 7.01C(2), 8.16C(2). The failure to give this notice does not affect the validity of the dissolution or revocation. \textit{id.}
\item 89. TEX. REV. CIV. STAT. ANN. art. 6607a, \S\ 3 (Vernon Supp. 1982). The statute does not pertain to corporate documents that have to be verified.
\item 90. \textit{id.}
\item 91. \textit{id.} art. 6607a \S\ 2(1).
\end{thebibliography}
II. Judicial Developments

A. Post-Dissolution Product Liability Claims

Products liability claims against dissolved corporations now present major problems under Texas law; these problems have only just arisen but will ultimately have to be addressed by the legislature or again by the Texas Supreme Court.

The classic products liability case was presented by the facts of *Fort Worth Capital Corp. v. Hunter*. In 1960 Hunter-Hayes installed an elevator in a building then under construction in Fort Worth. In 1975 Moeller, an employee of an elevator repair company, was seriously injured when the elevator fell on him as a result of the alleged negligence of Hunter-Hayes in installing and maintaining the elevator years earlier. Moeller sued the former shareholders of Hunter-Hayes on a product liability claim because Hunter-Hayes was no longer in existence, having sold its assets to Dover Corporation for 25,000 shares of Dover Corporation stock, distributed these shares to its shareholders, and dissolved, receiving a certificate of dissolution from the secretary of state on March 11, 1964.

The plaintiff in this situation traditionally has had two choices: First, he may proceed against the successor corporation, the purchaser of the original corporation's assets, under the "de facto merger" doctrine, or secondly, he may sue the former shareholders of the original corporation under the "trust fund" doctrine. These doctrines proceed on entirely different theories, but often are available alternatives to the injured plaintiff. The de facto merger doctrine assumes that the successor corporation continued the business of the original corporation much as before, and that the transaction had been cast in the form of a sale of assets without assumption of liabilities rather than a merger in order to avoid contingent or unknown liabilities, exactly the kind of liability raised by Moeller's injury. Numerous courts from various jurisdictions have applied the doctrine in similar situations. The trust fund theory, on the other hand, addresses the inherent unfairness of allowing the shareholders to receive the assets on dissolution undiminished by applicable liabilities. Unlike the de facto merger doctrine, the trust fund theory leads to liability of the shareholders who received the assets on dissolution.

---

92. 620 S.W.2d 547 (Tex. 1981).
93. Moeller actually sued multiple defendants including his employer and the building owner. Cross actions were filed by these other defendants against the shareholder of Hunter-Hayes. Id. at 548.
94. See cases cited at note 96 infra.
95. See cases cited at note 97 infra.
97. See, e.g., Nardis Sportswear v. Simmons, 147 Tex. 608, 218 S.W.2d 451 (1949).
Both of these doctrines now appear to be foreclosed in Texas. The result apparently is that plaintiffs are artificially barred from recovering anything from anyone on product liability claims following dissolution. In addition, unless the present rules are changed, corporations in the future may conceivably take regular “dissolution baths” to shed themselves of unknown and unwanted contingent product liability claims without a significant change in ownership.

Closing the “De Facto Merger” Door. The first Texas case recognizing the de facto merger doctrine arose in 1975.98 A purchaser of the assets of an insurance company was held liable on a claim of fraud arising from a pre-sale, pre-dissolution transaction by the insurance company even though the purchase agreement expressly disclaimed any intention to assume liabilities. The defendant vigorously argued that the plaintiff’s remedy should be against the former shareholders under article 7.12 of the TBCA.99 This argument was rejected by the court on the theory that the transaction was “tantamount” to a merger since the purchaser paid for the insurance company assets with its own stock, and that the plaintiff’s remedy against the selling shareholders under article 7.12 was “cumulative of other remedies . . . not an exclusive remedy.”100

In the 1979 legislative session the legislature shut the de facto merger door tightly by the enactment of the following provision to the “sale of assets” article of the TBCA:

B. A disposition of all, or substantially all, of the property and assets of a corporation requiring the special authorization of the shareholders of the corporation under Section A of this article:
   (1) is not considered to be a merger or consolidation pursuant to the Act or otherwise; and
   (2) except as otherwise expressly provided by another statute, does not make the acquiring corporation responsible or liable for any liability or obligation of the selling corporation the acquiring corporation did not expressly assume.101

The Bar Committee comment explicitly states that the purpose of this amendment was the preclusion of the de facto merger doctrine in situations involving the transfer of all or substantially all of one corporation’s assets to another entity.102

Federal courts also have recognized a trust fund concept. See, e.g., Pierce v. United States, 255 U.S. 398, 402-03 (1921) (government had right to pursue unsatisfied claims against dissolved corporation); United States v. Thomas, 515 F. Supp. 1351 (W.D. Tex. 1981) (shareholder of dissolved hospital personally liable to refund medicare overpayment because he received hospital assets on distribution; no reference to state law).

98. Western Resources Life Ins. Co. v. Gerhardt, 553 S.W.2d 783 (Tex. Civ. App.—Austin 1977, writ ref’d n.r.e.).
99. The statute, unchanged since 1955, is found at TEX. BUS. CORP. ACT ANN. art. 7.12 (Vernon 1980).
100. 553 S.W.2d at 787.
101. TEX. BUS. CORP. ACT ANN. art. 5.10(B) (Vernon 1980).
102. The 1979 amendment added Article 5.10(B), the purpose of which is to preclude the application of the doctrine of de facto merger in any sale, lease,
Closing the "Trust Fund" Door. Enactment of the prohibition against the de facto merger doctrine provoked little controversy in 1979. The issue was not well publicized, and the availability of a suit against the shareholders of the dissolved corporation appeared to provide an adequate alternative remedy. Apparently no one considered the potential problem of a claim arising after dissolution of the corporation and dissipation of its assets. A suit against the former shareholders seems more rational than a suit against the purchaser. The court need not ignore a clear provision of a contract negotiated at arms' length, but instead can impose liability on the persons benefiting from the original commercial conduct from which the liability arose.

In Hunter v. Fort Worth Capital Corp., however, the Texas Supreme Court construed the dissolution statute apparently so as to close down any possibility of a suit premised on the trust fund theory.103 Article 7.12, closely following section 105 of the Model Business Corporation Act,104 provides:

[The dissolution of a corporation] shall not take away or impair any remedy available to or against such corporation, its officers, directors, or shareholders, for any right or claim existing, or any liability incurred, prior to such dissolution if action or other proceeding thereon is commenced within three years after the date of such dissolution.105

Even though the statutory language seems on its face to relate only to claims arising prior to dissolution and not to post-dissolution claims the court read article 7.12 to exclude all post-dissolution claims:

[Earlier Texas statutes] supplant the equitable trust fund theory by declaring a statutory equivalent. In Texas, recognition of the trust fund theory, as applied to dissolved corporations, did not exist apart from these statutes.

We find no indication that the legislature intended for Article 7.12 to be interpreted any differently. Because the statute applies to officers, directors, and shareholders of a dissolved corporation, it embodies the trust fund doctrine but only to the extent that the doctrine

103. 620 S.W.2d 547 (Tex. 1981).
104. ABA-ALI MODEL BUS. CORP. ACT § 105 (1979).
105. TEX. BUS. CORP. ACT ANN. art. 7-12(A) (Vernon 1980).
allows recovery for pre-dissolution claims. Therefore, Article 7.12 expresses a legislative policy to restrict the use of the trust fund theory to pre-dissolution claims, and to protect shareholders, officers and directors of a dissolved corporation from prolonged and uncertain liability. See Bishop v. Schield Bantam C., 193 F. Supp. 94, 95 (N.D. Iowa 1968); Norton, [30 Bus. Law] at 1077.

Even if the trust fund theory did exist outside of these remedial statutes, we must assume that when the legislature enacted Article 7.12 it knew to what extent the equitable doctrine already provided a remedy for pre-dissolution claims. [citations omitted] With this in mind, no real purpose would be served by the enactment of Article 7.12, permitting suits against officers, directors, and shareholders of a dissolved corporation, unless the legislature intended for the statute to bar resort to the trust fund theory apart from the statute in order to enforce post-dissolution claims. To hold otherwise would violate the rule of statutory construction that the legislature is never presumed to do a useless act. [citations omitted] Accordingly, we hold Article 7.12 bars resort to the trust fund theory as it exists apart from the statute.\textsuperscript{106}

This mechanical analysis of the Texas statute effectively leaves remediless all plaintiffs in products liability cases arising from accidents occurring after the dissolution of the corporation. In addition, corporations conceivably could take regular "dissolution baths" to shed themselves of unknown and unwanted contingent product liability claims without a significant change in ownership. While some case law exists in other jurisdictions accepting this general construction,\textsuperscript{107} apparently none of these states has abolished the de facto merger doctrine by legislative enactment. Also, the court's interpretation of legislative intent is artificial because the language being construed was adopted in 1955, while Texas did not recognize products liability claims of the type presented by Moeller until 1967.\textsuperscript{108} Further, the court apparently was unaware that it was largely emasculating the alternative remedy that had made the earlier legislative decision to eliminate the de facto merger doctrine a rational approach. A large class of plaintiffs are now left without legal recourse; a result that I am confident that neither the Texas legislature nor the Texas Supreme Court intended. The problem so created seems suitable for being addressed either by the court or by the legislature in the future.

\textbf{B. Piercing the Corporate Veil}

While Texas courts deal yearly with significant numbers of cases which advance the doctrine of "piercing the corporate veil," they do not appear to struggle with the conceptual problems to the same extent as courts in

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{106} 620 S.W.2d at 550-51.
\item \textsuperscript{108} See McKisson v. Sales Affiliates, Inc., 416 S.W.2d 787 (Tex. 1967).
\end{itemize}
\end{footnotesize}
many states. Perhaps this is due to a helpful series of opinions of the Texas Supreme Court\(^\text{109}\) that tend to discount rhetoric and encourage concentration on the significant economic factors governing the application of this ubiquitous doctrine.

In *Torregrossa v. Szelc* the Texas Supreme Court refused to pierce the corporate veil to hold the corporate vice president (who was also a fifty percent shareholder) liable in a contract case for breach of warranty despite (1) a failure to follow corporate formalities and (2) nominal original capitalization of $1,000 in a business that obviously had a substantial cash flow and a substantial need for capital.\(^\text{110}\) The court pointed out that the sales lot at which the used automobile was purchased was identified by a sign showing that it was operated by the corporation and that all sales documents were exclusively in the name of the corporation.\(^\text{111}\) Further, the corporation maintained its own bank account. Although the vice president apparently was in a position of some authority and occupied an office on the business premises, the court stated that neither factor indicated that he personally was the owner of the business.\(^\text{112}\) The court's refusal to pierce the corporate veil on these facts was correct. So far as the failure to hold shareholders' or directors' meetings was concerned, the court noted that "[i]t is apparent that with but two shareholders, the corporate meetings would be very informal";\(^\text{113}\) thus, no personal liability should be imposed as this lack of formality was not shown to have hurt anyone.\(^\text{114}\) In addressing the minimum capital issue, the court distinguished other cases relying on inadequate capitalization\(^\text{115}\) as a basis for piercing the corporate veil. In those cases the inadequate capitalization was part of a "fraudulent scheme on the part of a major stockholder to acquire virtually all of the corporate assets to repay advances he had made." Such transactions, which injured creditors, constituted the "manipulation of the corporate form of business organization to serve the major stockholder's personal interest."\(^\text{116}\) This decision should be applauded. It is logical, conceptually sound, and appears to reach the proper result on the facts.

---


\(^{110}\) 603 S.W.2d 803 (Tex. 1980).

\(^{111}\) *Id.* at 804.

\(^{112}\) *Id.*

\(^{113}\) *Id.*

\(^{114}\) Consistent with this analysis are *Preston Farm & Ranch Supply, Inc. v. Biozyme Enterprises*, 615 S.W.2d 258 (Tex. Civ. App.—Dallas 1981, no writ); and *Urban v. First State Bank*, 609 S.W.2d 857, (Tex. Civ. App.—Austin 1981, no writ). *But see* United States v. Thomas, 515 F. Supp. 1351 (W.D. Tex. 1981), where, as an alternative ground of decision, the court pierced the corporate veil because of a failure to follow corporate formalities even though no one was injured by the lack of formality. It is regrettable that such unsound holdings continue to recur in this area.

\(^{115}\) *See, e.g.*, Tigrett v. Pointer, 580 S.W.2d 375 (Tex. Civ. App.—Dallas 1978, writ ref'd n.r.e.).

\(^{116}\) 603 S.W.2d at 805.
In the second case, Sagebrush Sales Co. v. Strauss,117 the Texas Supreme Court and the court of civil appeals in Texarkana118 disagreed sharply on the reasonable business inferences to be drawn from a very common factual pattern. A builder sought to establish a line of credit with a wholesale lumber dealer in order to build apartment houses. Apparently the precise nature of the legal entity to build the apartments—corporation, individual, or partnership—was never made clear. At the lumber dealer's request, a detailed financial statement was submitted in the name of "Richard C. Strauss, d/b/a/ Crawford Strauss Properties Co." This was clearly a personal financial statement of the individual, Robert C. Strauss.119 After the line of credit was approved in the name of "Crawford-Strauss," numerous purchases were made and paid for by checks drawn on a variety of "Strauss Investment" accounts. Purchase orders were uniformly made on the letterhead showing the purchaser to be "Crawford-Strauss Properties, Inc."120 and signed by an employee as "purchasing agent." The Texarkana court ordered a take-nothing judgment be entered in favor of Strauss personally on the theory that the plaintiff should have obtained a financial statement of the corporation and a personal guaranty of the corporate debt by Strauss if it wished to hold Strauss individually.121 The Supreme Court reversed, stating that personal liability should be imposed "only in extraordinary circumstances,"122 but that jury conclusions imposing liability on these facts were justified.123 The court stated that the letterhead "Crawford-Strauss Properties, Inc." and the use of a "purchasing agent" were not sufficient to charge the plaintiff, as a matter of law, with knowledge that it was contracting with a corporation.124

On the facts set forth, the conclusion by the Texas Supreme Court not only seems reasonable but also quite plausible. The corporate form does lend itself to the abuse of being "slid in" to a transaction after the other party is led to believe it is dealing with an individual. In such circumstances, a persuasive argument can be made for "piercing the corporate veil."125 These facts seem to present a good example of this problem.

On remand the Texarkana court of appeals remanded back to the trial court for further factual findings but restated its view of the facts that the plaintiff had not followed "good business practice"126 in the transaction. The Texarkana court assumed that the plaintiff knew or should have known it was dealing with a corporation from the outset. If this were true,
it would indeed be "good business practice" to obtain a financial statement of the corporation and to obtain a written guaranty by the shareholder if one expects to hold him responsible for the corporate obligations. If one starts with the assumption that the lumber dealer reasonably believed he was dealing with an individual from the outset, however, its conduct seems completely rational. For example, one who is relying on an individual obligor would not ask him to guaranty his own debt. Thus, the disagreement comes down to whether the lumber dealer should have realized a corporation was being "slid into" the negotiation.

In City of El Paso v. Del Norte Golf127 the court refused to hold the directors of a country club personally liable for breach of a lease agreement even though there was "almost total disregard for corporate formalities,128 and a "very loosely run corporation [with] very poor bookkeeping."129 Consistent with the Texas Supreme Court cases discussed above, the El Paso court held that such failure did not amount to the corporation being a sham, and that because the jury had concluded that the directors did not act with a fraudulent intent, no personal liability should be imposed.130

Two cases arising during the survey period involved the piercing the corporate veil doctrine in the context of promises or statements by officers that could be interpreted as personal assumption of the obligation of the corporation. In Keith v. Woodul131 the court held that the statute of frauds barred the imposition of personal liability on the basis of an oral promise by the defendant to pay a corporate obligation.132 While in similar cases the judicially created "main purpose" exception to the statute may permit enforcement despite the absence of a writing,133 nothing in Keith indicated any direct benefit to the defendant, a conclusion that the court phrased in terms of "absence of consideration."134 In asserting the piercing the corporate veil argument, the plaintiff showed only that the defendant was an officer and owner of the corporation, that the payroll checks contained the name "Keith Insulators Company, Inc.,” that the business cards used by salesmen had the defendant’s initial ("K") printed on them, and that the defendant remained an officer despite several changes of the corporate

---

128. Id. at 172.
129. 603 S.W.2d 803 (Tex. 1980).
130. 614 S.W.2d at 170-71 (citing Torregrossa v. Szelc, 603 S.W.2d 803, 804 (Tex. 1980)). Consistent with this analysis are: Preston Farm & Ranch Supply, Inc. v. Biozyme Enterprises, 615 S.W.2d 258 (Tex. Civ. App.—Dallas 1981, no writ); Urban v. First State Bank, 609 S.W.2d 857 (Tex. Civ. App.—Austin 1981, no writ). But see United States v. Thomas, 515 F. Supp. 1351 (W.D. Tex. 1981), where the court, as an alternative ground of decision, pierced the corporate veil in part because of a failure to follow corporate formalities. Id. at 1357. An important element justifying personal liability, however, was that assets of the corporation were used to benefit the sole shareholder before satisfaction of corporate debts. Id.
132. Id. at 377; see TEX. BUS. & COM. CODE ANN. § 26.01(b)(2) (Vernon Supp. 1982).
133. See R. HAMILTON, supra note 11, § 588.
134. 616 S.W.2d at 377.
name. These facts clearly seem insufficient to hold the defendant personally liable on an "alter ego" theory.

The second case, Dunn v. Growers Seed Association\textsuperscript{135} involved the sale of a large amount of seed to a Haitian corporation, eighty percent of the stock of which was owned by the individual defendant. When the account was not paid, plaintiff brought suit on the twin theories of piercing the corporate veil and personal guarantee. The first theory failed because the facts made it abundantly clear that the plaintiff intended to deal with the corporation so there was no confusion of roles.\textsuperscript{136} Moreover, the evidence failed to show that the defendant had stripped the corporation of its assets.\textsuperscript{137} Although the defendant made one payment of a corporate debt with his personal check that later was reimbursed by the corporation, the court held that this isolated transaction did not constitute sufficient intermingling of assets to justify ignoring the separate existence of the corporation.\textsuperscript{138} The written guarantee of payment issue arose because such a guarantee had been demanded by the plaintiff when required payments had not been forthcoming. The corporation responded, "WE WILL GUARANTEE PAYMENT AS PROMISED," in a telegram signed by the corporate general manager, who was not the defendant, and the defendant himself had wired, "YOUR ACCOUNT IN LINE TO BE PAID IN FULL AT CLOSING" of a contemplated sale of the plantation.\textsuperscript{139} The court, however, held that these sketchy writings did not meet the memorandum requirements of the Texas statute of frauds\textsuperscript{140} because they did not contain all of the essential elements of the agreement.\textsuperscript{141}

In Lane v. Dickinson State Bank\textsuperscript{142} an employee attempted to assert a piercing the corporate veil argument to hold a nonshareholder bank and its president liable for injuring the corporation and rendering it unable to perform its contract with the plaintiff. The bank and its president had exercised control over the operations of the corporation when its financial condition declined, and Lane contended that the bank and the corporation therefore should be treated as one entity. The court concluded that this was the wrong theory to hold a third person liable for injuring the corporation.\textsuperscript{143} More plausible theories would be intentional interference with contractual relations, if the conduct was directed against the plaintiff, or involuntary bankruptcy, or insolvency proceedings, with the trustee suing

\textsuperscript{135} 620 S.W.2d 233 (Tex. Civ. App.—Amarillo 1981, no writ).
\textsuperscript{136} Id. at 237.
\textsuperscript{137} Id.
\textsuperscript{138} Id.
\textsuperscript{139} Id. at 236.
\textsuperscript{140} TEx. BUS. & COM. CODE ANN. §§ 26.01(a), 26.01(b)(2) (Vernon Supp. 1982).
\textsuperscript{141} 620 S.W.2d at 237-38 (citing Cohen v. McCutchin, 565 S.W.2d 230 (Tex. 1978)). The statute requires that "there must be a written memorandum which is complete within itself in every material detail, and which contains all of the essential elements of the agreement, so that the contract can be ascertained from the writings without resorting to oral testimony." Id. at 232.
\textsuperscript{142} 605 S.W.2d 650 (Tex. Civ. App.—Houston [1st Dist.] 1980, no writ).
\textsuperscript{143} Id. at 653.
the defendants for the benefit of the plaintiff and other corporate creditors for injury to the corporation.

Finally, the doctrine of piercing the corporate veil also may arise peripherally in marital property settlements. In *Duke v. Duke* the trial court ordered a corporation that was wholly owned by one spouse to execute a security agreement securing the payment of a promissory note to the other spouse. The court of appeals held that the order was improper because the corporation was not a party to the proceeding and under the facts could not be considered an alter ego of the shareholder-spouse. In *Vallone v. Vallone* the court similarly refused to treat the husband's corporation as his alter ego for purposes of distinguishing the spouses' community and separate property.

### C. Partnerships and Limited Partnerships

Texas law traditionally has considered a partnership to be an aggregate of individuals rather than an entity in its own right. With the enactment of the Texas version of the Uniform Partnership Act (TUPA) and its numerous entity oriented provisions, however, this earlier characterization gradually has given way in judicial decisions to an entity analysis. During the survey period the Texas Supreme Court continued this trend by upholding a Beaumont court decision that a partnership should be considered an "association" for venue purposes under subdivision 23 of article 1995. Therefore, in a suit against the partnership, the court stated that venue was proper in the county in which the cause of action arose. The court expressly disapproved two cases, which had been decided prior to enactment of the TUPA, that held a partnership not to be an association for purposes of the venue statute. In *Volpe v. Schlobohm* the court reaffirmed the principle that a partnership agreement, like any other contract, can be rescinded for mutual mistake of assumptions if "it is possible to
CORPORATIONS AND PARTNERSHIPS

restore the contracting parties to their original positions, and provided the rights of innocent third parties have not otherwise intervened." The basis for recission in *Volpe* was a misunderstanding as to whether certain Pepperidge Farms franchises were to be contributed to the partnership or retained as the individual property of the partners. Common law principles of waiver were applied by the court in a case involving the enforceability of a noncompetition penalty clause in the partnership agreement. In *Alford, Meroney & Co. v. Rowe* the court upheld a jury finding that the partnership waived its right to exact a penalty from a former partner in competition with the firm after his withdrawal. Waiver was apparently implied primarily from a statement by the partner that he would withdraw only if the penalty were waived (such a waiver had occurred in connection with at least one earlier withdrawal), followed by a partnership memorandum announcing the withdrawal and estimating that the loss of business would not be substantial.

One case during the survey period involved the issue of whether partnership agreements with third persons bind the partners' actions individually in connection with nonpartnership property. In *City Products Corp. v. Berman* a limited partnership executed a commercial lease containing a restrictive covenant against leasing space within one thousand feet to a person who would be in competition with the tenant. Berman, one of the partners who signed the lease as a general partner, individually owned a commercial building located across the street from the tenant that he subsequently leased to a competitor. The court held nevertheless that he was bound by the restrictive covenant which did not involve an illegal "trust" in restraint of trade.

Another case involved one partner's liability on notes executed by the second partner on behalf of the partnership. In *Womack v. First National Bank* the partnership was engaged in the business of breeding, raising, and selling pigs. The active partner executed several notes basically in the form:

"McClanahan Farms
By:  C.C. McClanahan"

The notes were not signed by H. Lane McClanahan, another partner in the enterprise. The proceeds of the notes were actually used in the pig raising business. The court upheld a jury verdict that execution of the notes was

155. 619 S.W.2d 210, 215 (Tex. Civ. App.—Amarillo 1981, writ ref'd n.r.e.).
156. 610 S.W.2d 446 (Tex. 1981).
157. *See Tex. Bus. & Com. Code Ann.* §§ 15.04, 15.02(b) (Vernon 1968). The statutes prohibit any monopoly, trust, or conspiracy in restraint of trade. *Id.* The term "trust" includes actions by two or more persons to restrict the "free pursuit of a lawful business," to prevent or lessen competition in the . . . sale . . . of tangible personal property," and to "refrain from engaging in business." *Id.* § 15.02(b).
158. 610 S.W.2d at 449-50. The court distinguished Schnitzer v. Southwest Shoe Corp., 364 S.W.2d 373 (Tex. 1963) in which the antitrust argument was sustained because not all those who executed the restrictive covenant had an interest in the leased property.
159. 613 S.W.2d 548 (Tex. Civ. App.—Tyler 1981, no writ).
within the actual authority of C.C. McClanahan and that such execution bound the partnership under section 9 of the TUPA. The court rejected an argument that a finding should have been made that the partnership was a “trading partnership” before liability was imposed on the basis of these promissory notes. Womack, the administrator of the estate of H. Lane McClanahan, also argued that the deceased partner was not bound on some of the notes because the partnership had been dissolved before these notes were executed. The court correctly held, however, that a previous partnership creditor such as the plaintiff was not bound by a dissolution unless he had received actual notice of it.

A handful of cases during the survey period involved the fiduciary duties of partners, particularly managing or general partners in a limited partnership. The Fifth Circuit in Palmer v. Fuqua applied Texas law in an action by a limited partner alleging that the general partner had usurped a partnership opportunity and breached his fiduciary duty to the limited partners. The partnership was engaged in the business of oil and gas leases and governed by an agreement which stated that “property . . . acquired in the area of interest owned by this Partnership shall be offered first to the Limited Partners.” The court found that the general partner had purchased leases, for his own behalf, located adjacent to certain of the partnership leases. The court, stating that a general partner with exclusive management authority owed a greater duty to the limited partners than normally was imposed, upheld the imposition of a constructive trust. Accordingly, the court required an accounting for all benefits obtained from the partnership opportunity, and further sustained the imposition of substantial exemplary damages.

In Crenshaw v. Swenson two limited partners were permitted to recover their capital contributions from the general partner who had engaged in self-dealing. The court found self-dealing by defendant Swenson from the following actions: conveying the limited partnership’s assets to her corporation; depositing the proceeds of the sale of that property in the corporate account; permitting the corporation to act as the general contractor in absolute control of the development of the limited partnership’s property; and personally taking an exclusive real estate brokerage listing and commission on the sale of the property. The court did not specify the precise duty that was violated, but observed that these facts showed “an aura of self-dealing which this court is unable to condone.

---

160. Id. (quoting TEX. REV. CIV. STAT. ANN. art. 6132b, § 9 (Vernon 1970)).
161. 613 S.W.2d at 555.
162. Id. at 555-56; see TEX. REV. CIV. STAT. ANN. art. 6132b, § 35(1)(b) (Vernon 1970).
163. 641 F.2d 1146 (5th Cir. 1981).
164. Id. at 1155, 1158.
165. Id. at 1158. The court disposed of defendant’s argument that a finding of a constructive trust must be evidenced by some writing to satisfy the Statute of Frauds and the Texas Trust Act by stating that those statutes were inapplicable. Id. at 1160.
166. 611 S.W.2d 886 (Tex. Civ. App.—Austin 1981, writ ref’d n.r.e.).
167. Id. at 891.
168. Id.
Partnership cases sometimes involve issues of contract construction rather than general legal principles. Wehmeyer v. A. J. Marshall & Sons,\(^\text{169}\) for example, involved a general partnership agreement providing that "[s]uch salaries to partners shall not be treated as expenses of the partnership in determining net profits or net losses, except by unanimous agreement."\(^\text{170}\) The court concluded that the trial court erred in deducting the active partners' salaries and taxes to determine distributable net profits absent evidence of an express agreement to that effect.\(^\text{171}\)

D. Inspection of Books and Records

Article 2.44 of the TBCA\(^\text{172}\) is a rather complex statute dealing with shareholder inspection of corporate books and records. Articles 2.44(B) and 2.44(C) create a statutory right of inspection for "a holder of record of shares for at least six (6) months . . . or . . . the holder of record of at least five percent (5%) of all the outstanding shares," while article 2.44(D) preserves a common law right of inspection for any "beneficial or record holder of shares."\(^\text{173}\) The major differences between the statutory and common law rights of inspection are that (1) the burden of showing a "proper purpose" is on the shareholder under the common law inspection right but is reversed under the statutory inspection, and (2) a person who is improperly denied a statutory right of inspection may recover from the corporation "all costs and expenses, including attorneys' fees," under article 2.44(C), while there is no analogous privilege with respect to the common law right.\(^\text{174}\)

Two cases arising during the survey period involved the application (or misapplication) of this statutory provision. In Fort Worth KJIM, Inc. v. Walke a person was held to be a "record owner" and, therefore, entitled to recover his attorneys' fees under article 2.44(C) even though the shares had been pledged to secure a corporate loan and were registered in the name of the creditor.\(^\text{175}\) Although the corporate records, specifically the documents relating to the loan, clearly reflected the nature of the pledge of the shares, it is hard to say that the shareholder was technically a "record owner."\(^\text{176}\) The second case, Chavco Investment Co. v. Pybus, held that while a right to a jury trial existed when the propriety of the purpose of the shareholder was controverted, the corporation could rebut an allegation of proper purpose only by alleging specific facts rather than conclusionary allegations.\(^\text{177}\) Otherwise, the court stated, corporations could defeat the

---


\(^{170}\) Id. at 734 (emphasis in original).

\(^{171}\) Id.


\(^{173}\) Id. art. 2.44 (B), (C), (D).

\(^{174}\) Id. art. 2.44(C), (D). See R. Hamilton, supra note 11, § 804.

\(^{175}\) 604 S.W.2d 362, 363 (Tex. Civ. App.—Fort Worth 1980, writ ref'd n.r.e.).

\(^{176}\) In holding that the plaintiff was entitled to the benefits of article 2.44(C), the court stressed that the corporation knew, and could verify by its own records, that the plaintiff was the owner of the shares. Id. at 363.

\(^{177}\) 613 S.W.2d 806, 809 (Tex. Civ. App.—Houston [14th Dist.] 1981, no writ).
shareholders’ inspection right by the mere recitation of “magic words.”\textsuperscript{178}

\textit{Chavco} also presented an issue of first impression in Texas: the rights of directors, as contrasted with the rights of shareholders, to inspect corporate books and records.\textsuperscript{179} The court, recognizing the management responsibilities of a director, held that a director’s inspection rights were absolute even though he was not accorded such right by statute.\textsuperscript{180} Moreover, in order to compel inspection, the director could obtain mandamus upon showing that (1) he was a director, (2) he demanded to inspect corporate books and records, and (3) inspection was refused.\textsuperscript{181} In both of these cases the court awarded expenses and attorneys’ fees to the plaintiffs under article 2.44(C). Obviously, corporations should be cautious in denying inspection right claims for formal or technical reasons.

\textbf{E. Corporate Agents}

In Texas a corporation can be held liable for exemplary damages only for the conduct of an agent who is more than “a mere servant; in other words, an agent who represents the corporation in such a manner that his acts are regarded as the acts of the corporation itself.”\textsuperscript{182} In one case during the survey period the court held that a person in charge of security at a retail store might be such an agent.\textsuperscript{183} The head of security was deemed to be more than a mere servant because he had authority to direct certain employees and he was given authority to manage the corporation’s entire security department, and therefore his acts were the store’s acts.\textsuperscript{184} The Texas Supreme Court, in another case, reinstated a jury verdict on the issue of apparent authority of a corporate officer because “more than a scintilla of evidence” had been presented showing that the officer possessed apparent authority.\textsuperscript{185} The court’s conclusion was based on the corporation’s establishment of a “chain of communication” by which the plaintiff dealt exclusively with the officer in question.

The authority of corporate officers, particularly the president, to enter into transactions on behalf of the corporation continues to give rise to litigation. In \textit{Urban v. First State Bank} the court held that the president had

\textsuperscript{178} See \textit{Uvalde Rock Asphalt Co. v. Loughridge}, 425 S.W.2d 818 (Tex. 1968) as a guideline for drafting allegations of fact sufficient to require a jury determination as to the shareholder’s purpose. 613 S.W.2d at 809. The appellant also failed to comply with several other procedural requirements in seeking a jury trial. \textit{Id.} at 808-09.
\textsuperscript{179} 613 S.W.2d at 809.
\textsuperscript{180} See 19 R. \textit{HAMILTON}, supra note 11, § 803.
\textsuperscript{181} 613 S.W.2d at 810.
\textsuperscript{182} \textit{Id.}
\textsuperscript{183} Ledisio Financial Servs., Inc. v. Viracola, 533 S.W.2d 953, 957 (Tex. Civ. App.—Texarkana 1976, no writ). In addition, a corporation is liable for exemplary damages if it authorizes or ratifies the malicious act or should have known that the servant would act in a malicious way. \textit{Id.}
\textsuperscript{184} Treasure City v. Strange, 620 S.W.2d 811, 813 (Tex. Civ. App.—Dallas 1981, no writ). The case involved a customer's charge of unlawful detainer by the security guard. \textit{Id.} at 814. \textit{See} \textit{Fort Worth Elevators Co. v. Russell}, 123 Tex. 120, 70 S.W.2d 397 (1934).
parol authority from the board of directors to execute a corporate promissory note. Although the corporation's bylaws required a board resolution in order to grant such authority, the court found it significant that they did not require a written resolution. Accordingly, the president's having met with the board and having received oral authorization for the transaction was sufficient to bind the corporation.

In a case involving a nonprofit corporation, the Texas Supreme Court held that corporate funds can be expended by the corporate officers in connection with litigation to which the corporation is a party. The court stated that the rule obtained even when a derivative suit was brought by minority shareholders to challenge controversial corporate actions. Moreover, the court held that such expenditures did not violate an injunction prohibiting corporate spending of monies for other than the conduct of ordinary business.

F. Involuntary Dissolution

Several cases arising during the survey period involved the statutory provisions authorizing involuntary forfeiture of a corporation's charter for non-payment of state franchise taxes and the corresponding right of the corporation to obtain reinstatement by the payment of all arrearages. Until reinstatement the Texas courts are closed to affirmative suits by a defaulting corporation. In one case the defendant waited to raise the issue of the plaintiffs' charter forfeiture until after the period for reinstatement had passed; this was too much for the court, however, and it held that the defense had been waived. This result makes considerable sense because the purpose of the charter forfeiture and reinstatement provisions is to raise revenue and not to give defendants unjustified windfalls.

An insurance company secured subrogation rights of a insured corporation that subsequently lost its charter for nonpayment of franchise taxes

187. Id.
188. Id.
189. Ex parte Edman, 609 S.W.2d 532, 533 (Tex. 1980). Statutory law provides a nonprofit corporation with the authority to sue or defend in its corporate name. TEX. REV. CIV. STAT. ANN. art. 1396—2.02A(2) (Vernon 1980).
190. 609 S.W.2d at 534.
191. Id.
193. TEX. TAX CODE ANN. § 171.252(1) (Vernon Pam. 1981) provides that a defaulting corporation "shall be denied the right to sue or defend in a court of this state." However, a corporation may be sued (and may defend) even though its charter has been forfeited. See, e.g., R.J. Carter Enterprises, Inc. v. Greenway Bank & Trust Co., 615 S.W.2d 826, 831 (Tex. Civ. App.—Houston [1st Dist.] 1981, no writ).
195. Id. at 84. The court additionally held that payment of the corporate franchise taxes due would relate back and revive rights that the corporation had at institution of the suit. Id. at 85.
in Rushing v. International Aviation Underwriters, Inc. In response to the defendant’s claim that the insurance company thereby was barred from instituting action, the court held first, that a subrogation claim, like an assigned claim, was fully transferred when the claim arose and could not be barred by forfeiture of the insured’s charter, and secondly, that barring the insurer’s suit would not further the statutory goal of assuring payment of the franchise tax. Finally, in Farris v. Sambo’s Restaurants, Inc. a federal district court applied the Texas franchise tax statute under the Erie doctrine, and dismissed a counterclaim filed by Sambo’s Restaurants, Inc. Sambo’s had qualified to transact business in Texas as a foreign corporation in 1969. In 1973 the corporation decided to discontinue its Texas operations and simply withdrew without paying accrued franchise taxes or filing required reports. As Texas lawyers know, this practice did not effectively terminate the withdrawing corporation’s relationship with Texas nor stop the running of franchise tax liabilities even after the charter was forfeited. That is the lesson that Sambo’s learned.

G. Registration of Securities Transfers

Earlier cases held that, under some circumstances, the refusal of a corporation to register a transfer of a security might constitute a tortious conversion of the security. In one case decided during the survey period the court held that a cause of action for conversion had not been established when the corporation refused to register the transfer because appeals by the contending parties had not been exhausted. The court further found no indication of a conspiracy between the corporation and one of the claimants to deny or delay the transfer to the claimant who ultimately succeeded in securing the transfer. A claim of fraudulent conversion was upheld in another case in which the plaintiffs had been assigned shares of stock but the controlling shareholder refused to register the transfer. The controlling shareholder first attempted to negotiate a purchase of the appellees’ interest, and when that failed he dissolved the corporation, giving notice only to the record owner of the shares.

Section 8.102(a)(1)(B) of the Texas version of the Uniform Commercial Code defines a “security” to include, among other things, an instrument that “is of a type commonly dealt in upon securities exchanges.” Under
similar definitions some courts in other states had held that securities of closely held corporations subject to buy-sell agreements or similar restrictions were not "securities" for purposes of article eight.\textsuperscript{207} Attempting to avoid this result, the 1977 revision to the official comments to section 8-102 of the Uniform Commercial Code stated explicitly that "[i]nterests such as the stock of closely-held corporations, although they are not actually traded upon securities exchanges, are intended to be included within the definitions of both certificated and uncertificated securities by the inclusion of interests 'of a type' commonly traded in those markets."\textsuperscript{208} Although this statement does not appear in the comments to the Texas Business and Commerce Code, the court of civil appeals relied upon it in \textit{Kenney v. Porter}\textsuperscript{209} in determining that contracts for the sale of closely held shares must meet the statute of frauds requirements of article eight.\textsuperscript{210} The court, however, recognized that the doctrine of promissory estoppel in appropriate cases might take a transaction out of section 8.319\textsuperscript{211} but concluded that on the facts in \textit{Kenney} (1) that the acts of forbearance or reliance to justify imposition of the doctrine were insufficient, and (2) that no showing was made that the defendants orally promised to execute a necessary writing.\textsuperscript{212}

Finally, the court affirmed a reformation of the buy/sell agreement as follows: "If the offeree fails to accept said offer within said sixty (60) day period of time, the dissatisfied partner shall [have the right to] purchase the stock of the offeree . . . ."\textsuperscript{213} The bracketed words were in the buy/sell agreement as originally written but were ordered eliminated by the court as the product of a mutual mistake since they were not reflective of the true intention of the partners, which was to make the arrangement mandatory and not optional.\textsuperscript{214} This minor reformation issue presents an obvious lesson for the draftsman of share transfer restrictions: a world of difference exists between a mandatory and an optional arrangement; the four little words "have the right to" encapsulate this critical distinction.

\section*{H. Issuance of Shares}

The Texas Constitution\textsuperscript{215} and TBCA\textsuperscript{216} make it clear that shares may not be issued except for the consideration specified by the board of directors. One case arising during the survey period involved the issuance of

\begin{itemize}
\item \textsuperscript{207} See Annot., 11 A.L.R. 4th 1036, 1043-44 (1982).
\item \textsuperscript{208} U.C.C. § 2-205, comment 2 (1978 version).
\item \textsuperscript{209} 604 S.W.2d 297 (Tex. Civ. App.--Corpus Christi 1980, writ ref'd n.r.e.).
\item \textsuperscript{210} \textit{Id.} at 301-02; see \textit{TEX. BUS. & COM CODE ANN.} § 8.319 (Tex. UCC) (Vernon 1968).
\item \textsuperscript{211} 604 S.W.2d at 303-04. See \textit{Wheeler v. White}, 398 S.W.2d 93 (Tex. 1965). Such cases typically involve a promise made in order to influence the conduct of the promisee.
\item \textsuperscript{212} 604 S.W.2d at 304-05.
\item \textsuperscript{213} \textit{Id.} at 305 (emphasis in original).
\item \textsuperscript{214} \textit{Id.} at 305-06.
\item \textsuperscript{215} \textit{TEX. CONST.} art. XII, § 6 provides that "[n]o corporation shall issue stock . . . except for money paid, labor done or property actually received."
\item \textsuperscript{216} \textit{TEX. BUS. CORP. ACT ANN.} art. 2.16 (Vernon 1980) tracks the language of the state constitution. Article 2.15 grants authority to the board of directors to fix the share value.
\end{itemize}
corporate shares. In War-Pak, Inc. v. Rice217 the organizational board minutes recited that 500,000 shares were acquired by the initial shareholders for $26,000 cash plus a piece of equipment (a "parker") worth $2,000. In fact, the two purchasers paid only $500 each. The court held that the shares were void in their entirety, a conclusion of considerable practical importance to subsequent investors who had paid one dollar per share for their shares.218

I. Usury

With the establishment of different usury rules for corporations and individuals,219 litigation has arisen regarding the limitation applicable in transactions involving both a corporation and the individual controlling shareholders. Clearly, a loan to a corporation that is personally guaranteed by the shareholder is treated as a loan to the corporation for purposes of the usury statute.220 On the other hand, if credit is extended to an individual and successively extended to his company after incorporation, the rate of interest may be usurious as to transactions entered into by the individual but not as to those of the corporation.221

J. Reservation of Legislative Power

Article 9.12 of the TBCA222 contains a traditional provision reserving to the legislature the right to regulate business corporations and preventing the vesting of property rights from corporate activities. By virtue of this clause, a corporation incorporated and doing business since 1946 under the name "Plastic Engineering and Sales Corporation" was required to delete the word "engineering" from its corporate name because of the enactment of legislation in 1965 regulating the use of the word "engineering" in corporate names.223

217. 604 S.W.2d 498 (Tex. Civ. App.—Waco 1980, writ ref'd n.r.e.).
218. Id. at 503-04.
219. A separate usury statute for corporations, Tex. Rev. Civ. Stat. Ann. art. 1302—2.09 (Vernon 1980), allows a corporation to agree to pay up to 1½ percent per month on borrowings in excess of $5,000. In 1981, alternative interest ceilings were adopted. Corporations now may agree to a rate of interest that does not exceed (1) twice the bank discount auction average rate for 26-week United States treasury bills or (2) the annualized or quarterly ceilings published by the Consumer Credit Commissioner. Id. art. 5069-1.04 (Vernon Pam. Supp. 1971-1981). The statute provides, however, that this ceiling may not drop below 18 percent nor exceed 24 percent. Id. art. 5069-1.04(b)(1). If the loan is for business, commercial, investment, or similar purposes and exceeds $250,000, the ceiling may rise to 28 percent. Id. art. 5069-1.04(b)(2).
221. Preston Farm & Ranch Supply, Inc. v. Bio-Zyme Enterprises, 615 S.W.2d 258 (Tex. Civ. App.—Dallas 1981, no writ) (credit charge of 12% per annum was usurious only as to the individual).
223. Kilpatrick v. State Bd. of Registration of Professional Eng'r, 610 S.W.2d 867, 871 (Tex. Civ. App.—Fort Worth 1981, writ ref'd n.r.e.). The statute proscribes the use of any form of "engineer" in a corporate name unless the corporation actually engages in engineer-
K. Enjoining Filing of Certificates of Dissolution

In Beall v. Strake\(^{224}\) a judgment creditor seized certificates representing shares of stock in an effort to satisfy his judgment. Upon learning that the shares would become worthless prior to an execution sale, the creditor attempted to enjoin a voluntary dissolution that he feared would result in the dispersal of corporate assets and loss of value of the seized shares. The creditor sued the corporation and its shareholders, including the debtor, in Brazos County and also brought a separate lawsuit in Austin to enjoin the secretary of state from issuing a certificate of dissolution.\(^{225}\) The latter suit was dismissed on the grounds that the issuance of a certificate of dissolution was purely ministerial.\(^{226}\) Furthermore, the court stated that all issues should be resolved by the litigation in Brazos County, although the secretary of state was not a party.\(^{227}\)

L. Statutory Bookkeeping Requirement

Article 2.44(A) of the TBCA requires each corporation to “keep correct and complete books and records of account and . . . minutes of the proceedings of its shareholders and board of directors.”\(^{228}\) The Texas Nonprofit Corporation Act contains essentially the same requirement.\(^{229}\) One case arising during the survey period involved the claim that an involuntary termination of employment was invalid because of the failure to record the action in the corporate minutes as required by the Texas Nonprofit Corporation Act.\(^{230}\) The court rejected this contention on the ground that the minutes were merely written records of acts of the corporation’s directors and the failure to record an action does not necessarily mean that it was invalid.\(^{231}\)

M. Jurisdiction, Venue, and Related Problems

In every survey period a large number of Texas cases deal with procedural issues that relate to corporate litigation. These cases often involve nothing more than an application of the Texas venue\(^{232}\) or long-arm\(^{233}\) statutes to the specific facts. Such cases may be important to an attorney who is seeking to find litigation involving factual patterns similar to his

---

\(^{224}\) 609 S.W.2d 885 (Tex. Civ. App.—Austin 1980, writ ref’d n.r.e.).
\(^{225}\) TEX. Bus. CORP. ACT ANN. art. 6.02 (Vernon 1980) permits voluntary dissolution by consent of all the shareholders. The creditor sought to enjoin the filing on the ground that he was a shareholder and had not consented to the dissolution.
\(^{226}\) 609 S.W.2d at 887.
\(^{227}\) Id. at 887-88.
\(^{228}\) TEX. BUS. CORP. ACT ANN. art. 2.44(A) (Vernon 1980).
\(^{229}\) TEX. REV. CIV. STAT. ANN. art. 1396—2.23 (Vernon 1980).
\(^{230}\) Cameron & Willacy Counties Community Projects, Inc. v. Gonzalez, 614 S.W.2d 585 (Tex. Civ. App.—Corpus Christi 1981, writ ref’d n.r.e.).
\(^{231}\) Id. at 589.
\(^{233}\) Id. art. 2031b (Vernon 1964 & Supp. 1982).
case, but venue cases applied to specific facts usually are not of general interest. The brief discussion following deals with the few cases involving more general principles.

**Scope of Long Arm Jurisdiction.** The Texas Supreme Court has stated that the Texas long-arm statute reaches the limits permitted by due process. The Fifth Circuit, however, has construed the Texas statute so as not to reach torts committed outside Texas by nonresident defendants who have sufficient contacts with the state to be amenable to suit in this state. The court construed literally the language of the Texas statute as covering only actions "arising out of" contacts within the State; this construction, the court suggested, was so firmly rooted in the language of section 2031b that legislative amendment was required if this construction is to be changed.

A foreign corporation that guarantees the payment of an indebtedness payable in Texas is subject to the jurisdiction of Texas courts under the long-arm statute. Much litigation involving defects in service of process arises from attacks on default judgments. Texas courts have traditionally been generous in setting aside such judgments for defects in service of process. For example, in *Texas Inspection Services, Inc. v. Melville*, a default judgment was set aside because the secretary of state, in compliance with the statutory mandate to forward the process "by registered mail, addressed to the corporation at its registered office," had mailed it to "2525 Marilee" rather than "2526 Marilee," the corporation's actual registered office. The court rejected the argument that service was complete when it was made upon the secretary of state, holding rather that service could be effected only upon strict compliance with all statutory requirements, including the mailing of the process to the correct address of the registered office of the corporation. In a similar case a default judgment based on service on the secretary of state was set aside because the transcript did not show or recite any attempt to serve process on the registered agent of the corporation.

---

236. Id. at 1266 n.7.
240. 616 S.W.2d at 254.
241. Thomas Petroleum Prods., Inc. v. Rulon Elec. Co., 609 S.W.2d 890, 891-92 (Tex. Civ. App.—Houston [1st Dist.] 1980, writ ref'd n.r.e.). The court noted that had the record
Certain defects in the citation, however, will not render service of process void. In *Helfman Motors, Inc. v. Stockman* 242 service was directed to be made on the corporation's registered agent, "William A. Helfman." The sheriff's return recited that delivery was made to "William Helfman (Registered for serve in person)." This recitation, despite its obvious deficiencies, was held to be sufficient to support a default judgment.243

**Venue.** Most venue cases involve routine application of the statute to the specific facts. One case of somewhat broader interest held that a foreign corporation that is not qualified to transact business in Texas has no venue privilege under the Texas statutes and can be sued in any county in Texas.244 Another case held that the plaintiff may be a representative of the defendant in order to establish venue under the exception that the defendant have "agency or representative" in the county.245

**N. Securities Regulation**

**Application of Securities Acts to Real Estate Ventures.** Several of the cases arising during the survey period involve the issue whether an interest in a real estate venture constitutes a "security" for purposes of the federal246 or state247 securities acts. The broad test for this issue has been clearly established at least since the famous *Howey*248 decision established the basic requirements of an investment contract. There must be (1) an investment, (2) in a common enterprise, (3) on an expectation of profit solely to be derived from the efforts of others. However, the application of this test to real estate ventures has given rise to considerable litigation.

In general, a limited partnership interest is a security under both state and federal law249 unless the limited partner is also a general partner and therefore possesses a power of management. *Frazier v. Manson*250 involved a suit between two active general partners engaged in real estate development through limited partnerships. Plaintiff Frazier attempted to sue the other general partner in federal court alleging improper sale of

---

243. 97. at 396.
249. See Mayfield v. Troutman, 613 S.W.2d 339 (Tex. Civ. App.—Tyler 1981, writ ref'd n.r.e.) (relying on federal precedents). See also Westchester Corp. v. Peat, Marwick, Mitchell & Co., 626 F.2d 1212, 1217 (5th Cir. 1980) (commenting that the Texas courts "have engrafted the federal decisional law onto the state definition").
250. 651 F.2d 1078 (5th Cir. 1981).
limited partnership interests on the theory that he had acquired a "security" in the form of certain limited partnership interests. The court held that because Frazier was involved in the management of the limited partnerships, those partnerships were not securities as to him.251 The court recognized, however, that true limited partners might have had rights under the federal securities acts that the general partners by virtue of their power of management and control did not have.252

If the interest is a joint venture, general partnership, or similar interest, it may or may not be a security depending on the circumstances. For there to be a "security" there must be a commonality in the investment in the sense that the fortunes of the investors are dependent on the efforts of those seeking the investment.253 If, however, the investor has power to participate in management, the interest he has acquired is not a security even if he is in fact inactive and relies entirely on the managers of the enterprise.254 On the other hand, if the arrangement is structured so that he has no power of management the investment he makes may be a security.

*Statute of Limitations in Rule 10b-5 Actions in Texas.* In *Wood v. Combustion Engineering, Inc.*,255 a panel of the Fifth Circuit resolved the continuing controversy over the appropriate Texas statute of limitations to be applied to rule 10b-5 actions in favor of the general two-year Texas fraud statute256 rather than the three-year statute of the Texas Securities Act.257 This choice, on which several district courts had disagreed, was based in part on the effect of a recent Supreme Court decision on the scope of rule 10b-5 requiring scienter as an essential element of that cause of action.258 The court thought the scienter requirement made rule 10b-5 more analogous to the Texas fraud statute requiring scienter and reliance than the more relaxed standards for a cause of action under the Texas Securities Act.259

*Other Rule 10b-5 Litigation.* In another securities fraud case a whole range of issues relating to rule 10b-5 were decided.260 The court first held that suit could be based on section 10(b) under the Securities Exchange Act of 1934 and rule 10b-5 promulgated thereunder,261 even though the same

---

251. *Id.* at 1080.
252. *Id.* at 1081.
253. *Id.* at 1080.
255. 643 F.2d 339 (5th Cir. 1981).
256. TEX. BUS. & COM. CODE ANN. § 27.01 (Vernon 1980).
259. 643 F.2d at 344-45.
conduct also was actionable under section 12(2)\textsuperscript{262} of the Securities Act of 1933.\textsuperscript{263} This issue has been specifically reserved by the United States Supreme Court in two significant rule 10b-5 cases.\textsuperscript{264} Recent decisions in other courts of appeal, however, agree with the result reached by the Fifth Circuit that the claims are not identical under the two statutes, and the rule 10b-5 claim therefore does not make moot the specific limitations applicable to actions under the 1933 Act.\textsuperscript{265}

The court also outlined the elements necessary to establish the rule 10b-5 action for fraud: (a) misstatement or omission, (b) materiality, (c) scienter, which according to the court may be shown by recklessness,\textsuperscript{266} (d) reliance, and (e) causation.\textsuperscript{267} The court then considered the measure of damages for such actions under rule 10b-5, rejecting damages based on "recission" when the parties were not in privity of contract in favor of an "out of pocket" rule.\textsuperscript{268} Finally, the court decided that contribution among defendants in rule 10b-5 cases is permissible despite the general rule of \textit{in pari delicto}\textsuperscript{269} and that attorneys' fees should generally not be awarded in the absence of bad faith.\textsuperscript{270}

The rights of debenture holders are essentially a matter of contract law. The "contract" is the indenture, typically a lengthy and complex fine print document primarily of interest to attorneys. These documents, however, are critical in establishing the rights of securities holders and their "plain language" is unlikely to be augmented or supplemented by courts. This is graphically demonstrated by the Fifth Circuit's opinion in \textit{Broad v. Rockwell International Corp.} in which the court discussed at considerable length the conversion rights of convertible debentures following a merger of the issuer.\textsuperscript{271}

While the court stated that it was deciding the case "on far narrower grounds" than the panel opinion, and that it was mak[ing] no new law under Rule 10b-5 today, but merely apply[ing] well settled principles to the facts of this case,"\textsuperscript{272} the opinion does firmly commit the Fifth Circuit to the view that that "severe recklessness" was a substitute for "scien[ter]."\textsuperscript{273} The Court stated:

\begin{footnotesize}
\begin{enumerate}
\item 15 U.S.C § 77a (1976).
\item 640 F.2d at 543.
\item Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 752 n.15 (1975); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 211 n.31 (1976).
\item 640 F.2d at 545. The Fifth Circuit’s per curiam opinion on this issue confirms this result in \textit{Broad v. Rockwell International Corp.}, 642 F.2d 929 (5th Cir. 1981). \textit{See} G.A. Thompson & Co. v. Partridge, 636 F.2d 945 (5th Cir. 1981) (U.S. appeal pending).
\item 640 F.2d at 543.
\item \textit{Id.} at 554-55.
\item \textit{Id.} at 559.
\item \textit{Id.} at 559-60.
\item 642 F.2d 929, 940-57 (5th Cir. 1981).
\item \textit{Id.} at 960.
\end{enumerate}
\end{footnotesize}
Severe recklessness is limited to those highly unreasonable omissions or misrepresentations that involve not merely simple or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and that present a danger of misleading buyers or sellers which is either known to the defendant or is so obvious that the defendant must have been aware of it.\textsuperscript{274}

The court found little more than simple negligence, and certainly not severe recklessness.\textsuperscript{275}

\textit{Churning.} Most litigation involving "churning," that is, excessive trading by securities dealers in discretionary accounts in order to generate commissions,\textsuperscript{276} has arisen in other circuits. Indeed, the first Fifth Circuit churning case, \textit{Miley v. Oppenheimer & Co.},\textsuperscript{277} was decided during the survey period. This opinion recognized churning as a violation of both the federal securities law\textsuperscript{278} and the Texas imposed common law fiduciary duty of brokers. This opinion also resolved in a reasonable way several other significant substantive issues, including the liability of the broker for both refund of excessive commissions and declines in market value of the plaintiff's portfolio, the availability of arbitration as to the state law claims, and the appropriateness and reasonableness of punitive damages for churning violations.\textsuperscript{279} Furthermore, the court determined that a rule-of-thumb award of punitive damages for churning violations to the extent of three times the compensatory damages was not excessive.\textsuperscript{280}

\textit{Liability of Attorneys for Securities Act Violations.} In \textit{Junker v. Crory}, a Louisiana case brought in the Fifth Circuit, the court imposed liability on an attorney under section 12(2) of the Securities Act of 1933.\textsuperscript{281} This section imposes liability on a person who offers or sells a security on the basis of a false or misleading statement to a purchaser. Earlier cases had established that a person who was a "motivating force" in the sale might be liable under section 12(2).\textsuperscript{282} In evaluating the role of attorneys in connection with securities sales, the court distinguished the situation in \textit{Croy v. Campbell},\textsuperscript{283} in which a court held that an attorney who had only given tax advice in connection with the transaction was not a "seller."\textsuperscript{284} In contrast, the attorney in \textit{Junker} had initially suggested the transaction, urged

\begin{footnotes}
\footnote{274. 642 F.2d at 961-62.} 
\footnote{275. \textit{Id.} at 962.} 
\footnote{276. Churning is a violation of the antifraud provisions of the federal securities acts. \textit{See}, e.g., \textit{Mihara v. Dean Witter & Co.}, 619 F.2d 814, 820-21 (9th Cir. 1980).} 
\footnote{277. 637 F.2d 318 (5th Cir. 1981).} 
\footnote{278. This is a duty encompassed within the broad umbrella of rule 10b-5, 17 C.F.R. § 240.10b-5 (1981).} 
\footnote{279. 637 F.2d at 328-32.} 
\footnote{280. \textit{Id.} at 331.} 
\footnote{281. 650 F.2d 1349, 1362 (5th Cir. 1981); 15 U.S.C. § 77l(2) (1976).} 
\footnote{283. 624 F.2d 709 (5th Cir. 1980).} 
\footnote{284. 650 F.2d at 714.}
\end{footnotes}
its approval at the shareholders' meeting, and prepared the necessary documents to effect the transaction. He was, according to the court, a "key participant" and "active negotiator," not a "passive advisor." Another Fifth Circuit decision rejected a similar definition of "seller" under the Texas Securities Act and suggested that "seller" should be limited to those actively engaged in the sales process, not including those who merely participate in preparing an offering.

**Texas Securities Act Litigation.** In the single reported criminal proceeding involving the Texas Securities Act, a conviction for the sale of unregistered securities was upheld against the contention that the phrase, "public solicitation," was unconstitutionally vague. The court approved an instruction that a solicitation could be "public" even though it was not made to the whole world. In the only noteworthy civil case involving an injunction against violations of the Act, the court upheld the appointment of a receiver with broad powers under section 581-25-1 of the Act. The court reviewed carefully the statutory requirements for the appointment of a receiver and concluded that the facts justified the action.

---

285. *Id.* at 1360.
289. *Id.* at 162.
291. 611 S.W.2d at 150-51.