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Corporations

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SEVERAL important cases in the area of corporation law were decided during the current survey period. The classification below is based on the types of problems involved in these cases and does not follow the specific format of the previous Survey Articles.

I. PIERCING THE CORPORATE VEIL

In Coastal States Petrochemical Co. v. Cooper Petroleum Co. Coastal States had made gasoline sales on open account to International Marketing, Inc. (IMI), a corporation related to Cooper. The jury found that IMI's vice president had innocently represented that Cooper would stand behind IMI's debts as an inducement to Coastal States to enter into the transaction in question. However, when IMI became insolvent, Cooper refused to pay IMI's debt and Coastal States sought to hold both Cooper and its president liable. Coastal States argued that the separate corporate entities of the two companies should be disregarded since IMI was the "alter ego" of Cooper Petroleum and was being operated to facilitate a wrong. The court refused to hold Cooper liable, relying on a showing that the two companies had been operated separately, had different officers, and that Coastal States knew of their separate corporate existence. The court also refused to hold that Cooper's use of IMI as its trucking agent to avoid certain common carrier rates was a wrongful use of IMI's corporate existence which would justify disregarding the separate corporate entity of the two companies.

In refusing to disregard the separate corporate existence of Cooper and IMI, the court recognized the distinction between contract and tort claims which was drawn in Bell Oil & Gas Co. v. Allied Chemical Corp. In that case it was stated that the corporate veil would be pierced in a suit for breach of contract only when the plaintiff could show that the corporate arrangement was fraudulent or was being used as a basically unfair device. Quoting an early article by Mr. Justice Douglas, the court stated that since the contracting party dealt voluntarily with the corporation, "[a]dditional compelling facts must appear" before the corporate veil should be pierced. Since Coastal States had entered into a contract with IMI

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** B.A., Texas Tech University; Second-year student at the University of Texas School of Law.
1 444 S.W.2d 214 (Tex. Civ. App.—Houston 1969), error ref. n.r.e.
2 Id. at 218.
4 444 S.W.2d at 219, quoting Douglas & Shanks, Insulation from Liability Through Subsidiary Corporations, 39 YALE L.J. 193, 211 (1929).
knowing that it was a separate corporation from Cooper, the court correctly refused to hold Cooper liable for IMI’s debts in the absence of a showing of fraud or unfair purpose in the corporate arrangement between IMI and Cooper. As discussed below, the representation that Cooper would stand behind IMI should not be sufficient of itself to show such fraud or unfair purpose, at least in the absence of a showing that the statement was knowingly false when made.

In the last Annual Survey the basic policy principles underlying the decision to ignore the separate corporate existence in tort cases was discussed. Entirely different considerations are applicable in contract cases. In claims of a contractual origin, the party who seeks to have the corporate entity ignored has dealt with the corporation and can obtain information about its financial condition. If he feels insecure because he is dealing with a corporation without substantial assets, he can refuse to contract with the corporation unless a shareholder or parent corporation personally guarantees its performance. He usually should not be heard to complain if he chooses to deal with a nominally capitalized corporation, which thereafter becomes insolvent. In addition, the use of a “shell” corporation may simply be a device to place the risk of loss from the transaction on the third person rather than on the shareholder, and generally such allocations of the risk of loss should not be disturbed. In contrast, in a tort claim, the plaintiff usually has no prior contact with the corporation and has not voluntarily dealt with it. As a consequence, in tort cases, the issue usually becomes whether a shareholder should be permitted to shift the risk of loss from injury to members of the general public.

It might be argued that “additional compelling facts” were present in the Coastal States case because IMI’s vice president orally represented that Cooper and its president would stand behind IMI’s debt. Normally, a promise to guarantee the indebtedness of another must be in writing, and an oral guarantee is unenforceable. In addition, there is substantial doubt whether a corporate guarantee is ultra vires under Texas law. Therefore, normally an oral representation similar to the one involved in this case should not be considered sufficient to permit the separate corporate entity of the subsidiary to be ignored. However, a considerably closer case would be presented where the person making the representation did so when he knew that the corporation did not in fact intend to pay the indebtedness. Perhaps in that situation, the person making the representation would himself be liable for the indebtedness under a fraud theory.

A second case decided on the authority of Bell Oil does not really concern a problem of ignoring the separate corporate entity. In Hubbard v. Capital Southwest Corp., the shareholders and bondholders of Great American Realty Corporation brought a derivative suit alleging that

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Capital Southwest Corporation had used its ownership of a controlling interest in Great American to make Great American its alter ego and cause it to become heavily indebted to Capital Southwest. Recovery was sought for the amount of the indebtedness. In other words, even though the complaint was framed in terms of "alter ego," the minority shareholders were seeking to test the propriety of a transaction between the corporation and its majority shareholder. The court purported to apply the Bell Oil test, and refused to disregard the separate corporate entity. This case actually concerned a claimed breach of fiduciary duty by the majority shareholder and not the question whether the separate existence of two corporations should be recognized. Since (1) there was no evidence of fraud or "other compelling circumstances" in the establishment of the intercorporate debt, (2) the plaintiffs had been active participants without objection in the financial arrangements between the two corporations, and (3) it appeared that the majority shareholder was attempting to rescue Great American rather than deprive it of assets, the transaction appears to have been fair and the conclusion that the complaint did not state a cause of action seems correct.

Ragland v. Curtis Mathes Sales Co. was the only case during the survey period in which the corporate entity was disregarded. Ragland had negotiated with Curtis Mathes to obtain a distributor franchise to sell Curtis Mathes' products. To make the franchise agreement functional, Ragland formed a corporation which actually signed the franchise contract. The contract contained a standard merger clause stating that the contract constituted the full agreement between the parties. When a dispute between the parties arose, Ragland sued on the franchise contract to recover his investment, claiming that Curtis Mathes had breached an oral agreement to provide management for the franchise. Curtis Mathes claimed that the parol evidence rule barred evidence of the alleged oral agreement because it was made prior to, and was merged in, the written franchise contract. Ragland claimed that the parol evidence rule was not binding on him, since he was not a party to the written franchise contract, which was executed in the name of the distributor corporation. The court held that the evidence established that the distributor corporation was Ragland's alter ego, and that Ragland "was a beneficiary of the contract, and in privity with the party executing it to the extent that he may not properly claim to be a stranger [to the contract]."

While it seems clear that Ragland should be bound by the parol evidence rule even though technically he was not a party to the contract, the court's reasoning is not entirely satisfactory. Ragland was technically neither a beneficiary of the contract, nor in privity with his own corporation. He was merely a shareholder in the corporation and, as such, was indirectly interested in the outcome of the transaction. In cases of this nature, the policies underlying the substantive rule may dictate that the

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10 Id. at 578.
corporation's separate existence be disregarded even though the normal doctrine of piercing the corporate veil would not require it. For example, a shareholder personally negotiating a contract should not be able to avoid the parol evidence rule merely because at the last moment it was decided to enter into the transaction in the name of his corporation. For this purpose, but not necessarily for other purposes, the shareholder and the corporation together should be considered a single entity. The same result may be reached under the more traditional language of the cases by arguing that recognizing the separate existence of Ragland's corporation would work a "fraud" on Curtis Mathes by allowing Ragland to escape the application of the parol evidence rule. It is believed, however, that formulating the test in this way tends to hide the significance of the noncorporate, substantive law policies which should determine the ultimate outcome.

II. THE TEXAS SECURITIES ACT

In Koscot Interplanetary, Inc. v. King the issue was whether a cosmetic manufacturer's sale of distributorships amounted to the sale of a "security" that must be registered under the Texas Securities Act. Koscot sold its cosmetics through a multilevel marketing scheme involving three levels of distributorships. At the base were "beauty advisors" who sold cosmetics to the ultimate consumer. Beauty advisors were supplied cosmetics by "supervisors," who in turn were supplied cosmetics by "directors." Directors and supervisors could make profits either through the sale of cosmetics to the next lower marketing level in the chain, or through the sale of new director or supervisor distributorships. The trial court found that the principal attraction to investors in distributorships was not the hope of profits through the sale of cosmetics, but the prospect of large profits through the sale of distributorships. The trial court also found that Koscot represented to investors that the sale of distributorships could be accomplished mainly through the efforts of others with a minimal amount of effort on the individual investor's part, and that Koscot obtained working capital through the sale of distributorships. The trial judge held that the sale of director and supervisor distributorships by

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12 452 S.W.2d 531 (Tex. Civ. App.—Austin 1970), error ref. n.r.e.
13 The Texas Securities Act defines a security as:
   [A]ny share, stock, treasury stock, stock certificate under a voting trust agreement, collateral trust certificate, equipment trust certificate, preorganization certificate or receipt, subscription or reorganization certificate, note, bond, debenture, mortgage certificate or other evidence of indebtedness, any form of commercial paper, certificate in or under a profit sharing or participation agreement, certificate or any instrument representing any interest in or under an oil, gas or mining lease, fee or title, or any certificate or instrument representing or secured by an interest in any or all of the capital, property, assets, profits or earnings of any company, investment contract, or any other instrument commonly known as a security, whether similar to those herein referred to or not.
14 Id. art. 581, § 7.
Koscot amounted to the sale of a security within the meaning of the Texas Securities Act, and issued a cease and desist order until Koscot satisfied the registration requirements of the Act.

The Austin court of civil appeals reversed the trial court, holding that Koscot's sale of distributorships did not amount to the sale of a security. The Court concluded that the only parts of the Texas statutory definition of a "security" which were applicable to the Koscot distributorship plan were "participation agreements" and "investment contracts." In deciding whether Koscot's sale of distributorships amounted to the sale of an investment contract, the court followed the definition of investment contract which had been given by the United States Supreme Court in SEC \textit{v. W. J. Howey Co.}, the leading case under the Securities Act of 1933. The Court in \textit{Howey} had defined an investment contract as "a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party . . . ." Applying the \textit{Howey} test, the court of civil appeals held that since the investors in Koscot's director and supervisor distributorships did not rely solely on the efforts of others for profit, but could make profits on their own through the sale of cosmetics, the sale of distributorship plans was not the sale of an investment contract, and thus not the sale of a security within the meaning of the Texas Security Act.

The court's application of the Supreme Court's interpretation of investment contract points out that with regard to the problem of "what is a security," federal and state cases are often interchangeable. Section 2(1) of the Securities Act of 1933 was modeled on the definition of a security contained in many of the earlier state blue sky laws and has in turn influenced many of the new state statutes enacted since 1933. The \textit{Howey} case has been described as "destined to become the one most cited on the meaning of 'investment contract' under both federal and state [securities] statutes," and the court's holding in \textit{King} is in line with the great weight of authority on this subject. As noted by the court, the problem of protecting the public from get-rich-quick schemes is difficult, especially in view of the great number of schemes used, which have been described as being "as variegated as the imaginations of promoters." However, the efforts by states to use their securities acts to regulate such schemes have been largely unsuccessful. As the court of civil appeals in \textit{King}
aptly puts it, the problem is that "[n]ot all 'get rich quick schemes' are securities." Due to the success promoters have had in tailoring their schemes so that they do not come within the statutory definition of a security, meaningful legislative control of such schemes will have to come from outside the present framework of the state securities acts.

III. CORPORATE DIRECTORS' FIDUCIARY DUTIES

A. The Interested Director

*Western Inn Corp. v. Heyl* raises the question whether it was a breach of fiduciary duty for a director to make loans to his corporation, take as security a deed of trust on the corporate property, and then later foreclose the loan and purchase the corporate property at foreclosure. The defendants and plaintiffs were directors and stockholders in a corporation which undertook to build the Western Hills Inn in Euless, Texas. From the beginning, the corporation had problems obtaining financing for the construction and operation of the hotel. Both the plaintiffs and defendants were called on to lend substantial sums to keep the project going. It finally became clear that large amounts of new capital would have to be raised for the construction to be completed. The defendants orally agreed with the plaintiffs that they would secure the necessary financing for the project in return for fifty per cent of all profits and control of the project. The defendants began making loans to the corporation in February 1958, and advanced a total of over $435,000 of their own funds. These loans were evidenced by promissory notes which were secured by deeds of trust on the corporate assets. In May 1961, the defendants met with the plaintiffs and informed them that they would be unable to put any more money into the hotel and requested that plaintiffs advance the needed funds. The plaintiffs refused, taking the position that the defendants were bound by their earlier oral agreement to furnish all necessary financing. The defendants then informed plaintiffs that they would have to foreclose their liens on the hotel in order to protect their interests. In July 1961, after defendants had resigned as directors, they purchased the hotel property at foreclosure for $1,017,042.31. In March 1965, the plaintiffs brought suit as shareholders against the defendants as directors, charging that they violated their fiduciary duties in acquiring title to the hotel through foreclosure, and asking that a constructive trust be impressed on the hotel in their favor. The plaintiffs alleged that they were the victims of a conspiracy by the defendants to gain control of the hotel through malicious and wrongful acts, including the creation of the financial crisis by gross mismanagement.

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23 452 S.W.2d at 539.
24 See *Florida Discount Centers v. Antinori*, 232 So. 2d 17 (Fla. 1970) (discount center's marketing scheme held violative of both the state securities act and a state statute prohibiting "pyramid clubs").
25 452 S.W.2d 752 (Tex. Civ. App.—Fort Worth 1970), error ref. n.r.e.
26 Most jurisdictions allow directors in certain circumstances to make loans to their corporations and take and enforce security therefor. See 3 W. FLETCHER, PRIVATE CORPORATIONS § 952 (perm. ed. rev. 1961) [hereinafter cited as FLETCHER].
of the hotel. The plaintiffs charged that, since foreclosure, the operator of the hotel had made improvements in management which had made the hotel profitable and which he should have made before foreclosure.

The trial court found for the defendants, holding that they had not mismanaged the hotel and had not participated in any conspiracy to obtain control of the hotel. As to the defendants' loans to the corporation, the court found that as to each loan there had been full disclosure of the amount, terms, and security to the board of directors, and that the board and stockholders had unanimously approved each transaction.

In upholding the directors' loans to their corporation and their subsequent foreclosure, the court of civil appeals pointed out that in Texas "interested director" transactions are not void, but only voidable upon a showing of unfairness to the corporation. Since the loans were found to be reasonable in their terms and made upon full disclosure, and since the defendants had paid a fair price for the hotel at foreclosure, the court held that the transactions complained of were fair to the corporation and thus not voidable. Further, any issue as to whether the defendants' votes as interested directors affected the validity of the board of directors' actions in approving the loans was said to be removed by the subsequent unanimous shareholder ratification which removed "any taint of control" the defendants may have exerted over the Board.

The court's decision on this type of problem is in line with previous authorities in Texas and elsewhere. Although there is an early line of Texas cases holding that transactions in which a director is interested are voidable regardless of fairness, later cases have clearly established the principle that interested-director transactions are not void but only voidable by the corporation upon proof of unfairness.

In addition to fairness, some Texas cases have upheld interested-director transactions when they have been approved by a majority of the disinterested board of directors. However, Henger v. Sale upheld a fair interested-director transaction even though there had been no approval of the transaction by a disinterested board of directors. The view of the Henger case, that fair-

87 See, e.g., International Bankers Life Ins. Co. v. Holloway, 368 S.W.2d 567 (Tex. 1963); Popperman v. Rest Haven Cemetery, Inc., 162 Tex. 255, 345 S.W.2d 715 (1961); Tenison v. Patton, 95 Tex. 284, 67 S.W.2d 92 (1902); Lebowitz, Director Misconduct and Shareholder Ratification in Texas, 6 BAYLOR L. Rev. 1, 17 (1951) [hereinafter cited as Lebowitz]; Lebowitz, Recent Decisions on Fiduciary Duties to Corporations, St. B. of Texas Section on Corp., Banking & Bus. L., May 1963, at 1; Comment, The Interested Director in Texas, 21 SW. L.J. 794, 801 (1967). The Texas view is in accord with the majority of jurisdictions. See FLETCHER § 5931.

88 412 S.W.2d at 759. As an alternative basis for its decision, the court held that plaintiff's suit was barred by res judicata and the statute of limitations, Id. at 762.


90 See authorities cited in note 27 supra.


92 365 S.W.2d 331 (Tex. 1963). But see FLETCHER § 937.
ness should be the test for determining whether an interested-director transaction should be upheld, seems sound. Transactions which are fair to the corporation should be upheld even if they have not been approved by a disinterested board of directors. Alternatively, if the transaction does not involve fraud, undue overreaching, or waste, either approval by a disinterested board of directors or subsequent ratification by a majority of the shareholders should be sufficient. Shareholder ratification of an interested board of directors' approval of an interested-director transaction can be equated to that of a disinterested board ratifying the action of an interested director. Questions may arise as to whether effective ratification may be made by a majority of the shareholders or only by unanimous vote, and whether the interested directors may vote their shares to ratify the transaction. On the first question, majority shareholder approval should be sufficient if the transaction does not involve fraud, undue overreaching, or waste. Also, the Texas cases have, without discussing the issue, assumed that interested directors may vote their shares to ratify the transaction in which they were interested. Any other view might have the effect of turning the corporation over to minority interests. In the instant case, the board's action in approving the loan by the directors to the corporation was ratified unanimously by all the shareholders. Certainly this should remove any "taint of control" the interested directors may have had, and should of itself validate the transaction.

B. Directorial Liability for Tortious Conduct

In Maxey v. Rodman the El Paso court of civil appeals considered the issue of a director's liability for alleged tortious acts of employees, officers, and other directors. Plaintiff charged that certain officers, directors, or attorneys of a Lubbock bank had conspired to obtain a wrongful and fraudulent foreclosure of his real property. Plaintiff claimed that the defendants induced him to transfer his funds to the Lubbock bank and to give the bank mortgages on his property, but when the mortgages came due, the bank foreclosed after the bank's attorney had fraudulently cancelled a loan commitment plaintiff had obtained to pay off the mortgage. Plaintiff presented two theories: (1) the defendants should be held liable as co-conspirators; and (2) even if the conspiracy charge should

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29 See Wiberg v. Gulf Coast Land & Dev. Co., 360 S.W.2d 563 (Tex. Civ. App.—Beaumont 1962), error ref. n.r.e., noted in 41 Texas L. Rev. 726 (1963); Pruitt v. Westbrook, 11 S.W.2d 562 (Tex. Civ. App.—Fort Worth 1928) (dictum); Lebowitz 27. See also FLETCHER § 982.
30 Lebowitz 27.
31 For a discussion of these questions, see Lebowitz 27-31. Professor Lebowitz concludes: "[I]t is felt that ... Texas will follow the general rule and hold that a shareholder is not disqualified per se from voting to ratify his own conduct as a director and that such ratification will be effective so long as no fraud or oppression is perpetrated on the minority shareholders." Id. at 31. But see FLETCHER § 983.
34 444 S.W.2d 353 (Tex. Civ. App.—El Paso 1969), error ref. n.r.e.
fail, the defendants should be liable because, as directors, they are responsible for the torts or conspiracies of employees, officers, and other directors without regard to their personal knowledge of the others' actions.

Plaintiff's first theory failed because he could not present any facts connecting the defendants with the alleged conspiracy. The court of civil appeals rejected his second theory and held that the defendants, as directors, were not responsible for the actions of employees, officers, and other directors in the absence of a showing that they had participated in, or been connected with, the alleged wrongdoings. This holding is in accordance with the general rule that directors are not personally liable to third parties for the torts of their corporation, or of other directors, unless they personally participated or cooperated therein. Other Texas cases follow this rule, and one case stated that the reason directors are not liable for the torts of other directors unless personally participating is that "the liability of corporate officers and directors does not grow out of the fact that they occupy such positions, but springs out of their participation in the wrong."

IV. RIGHTS OF DISCHARGED EMPLOYEES IN PROFIT-SHARING AND OTHER BENEFIT PLANS

Two cases during the survey period dealt with a management committee's discretion in administering an employer-funded benefit plan. *Neuhoff Bros. Packers Management Corp. v. Wilson* concerned a discharged employee's right to his share in a profit-sharing plan. Plaintiff had worked as a cattle buyer for defendant for over twelve years, attending various auction sales and making purchases in defendant's behalf. In 1964, plaintiff began accepting payments of $25 per week from one of the auction barns. Since the auction barns represented cattle sellers, while plaintiff was obliged by his employment agreement to purchase cattle at the lowest possible price, plaintiff's receipt of the payments raised a serious question of his loyalty to defendant. Plaintiff was discharged when defendant learned of the payments, and thereafter he requested payment of his vested share of the company's profit-sharing plan, which amounted to more than $16,000.

The instrument governing the plan provided "if the participant's employment has been terminated by reason of dishonest or fraudulent conduct he shall forfeit the entire amount of his account." Another provision set up a management committee to administer the plan and gave it power "[t]o construe all terms, provisions, conditions and limita-

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40 See FLETCHER § 1137.


43 413 S.W.2d 472 (Tex. 1970).

44 Id. at 473.
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46 Long v. Southwestern Bell Tel. Co., 442 S.W.2d 462 (Tex. Civ. App.—San Antonio 1969), error ref. n.r.e. The decision by the court of civil appeals in the instant case was handed down two days after the decision in the Long case. Faced with basically inconsistent decisions by two courts of civil appeals, the supreme court resolved the conflict by writing an opinion reversing the principal case, while refusing the writ in the Long case because of no reversible error.


48 Bruner v. Mercantile National Bank, the plaintiff was denied benefits under the disability provisions of his employer's retirement plan. Plaintiff had been a welder when he suffered a cerebral hemorrhage, which left him severely paralyzed. After a few months, plaintiff returned to work but was unable to return to his former position as a welder. He was therefore assigned work consisting of removing the sharp edges of newly manufactured metal pieces by the use of sandpaper and other abrasives. Plaintiff was thereafter discharged, and there was evidence that the

49 Id.
reason for the discharge was that he insisted on returning to a welding job, even though the employer thought it was unsafe for him to engage in this type of activity. Plaintiff then filed an application for disability benefits under the company’s retirement plan.

The instrument governing the retirement plan was similar to the instrument in Neuhoff. It provided that employees who were, in the opinion of the retirement committee, totally and permanently disabled were entitled to disability benefits. The retirement committee had the power to construe the plan and make all determinations thereunder, and “all such determination made by the retirement committee in good faith shall not be subject to review by anyone.” After consulting with counsel, the retirement committee ruled that plaintiff was not totally and permanently disabled and denied his application for benefits. The jury found that plaintiff was totally and permanently disabled, but that the retirement committee had acted in good faith in making its determination. Based on the finding of good faith, the trial court entered judgment for defendants, and plaintiff appealed.

On appeal, plaintiff contended that the trial court should have disregarded the jury’s finding of good faith, since he “had a vested property right in the retirement benefits and an inherent right to appeal the decision of the Committee.” Plaintiff also contended that the provision in the plan making the committee’s determination binding and unreviewable should be held void as violative of the due process clause of the Federal Constitution and as against public policy. In support of his argument, plaintiff alleged that the clauses: (1) deprived the employee of an inherent right to appeal; (2) usurped the power of the courts; and (3) allowed the company the right to judge its own case. The court of civil appeals, citing the Neuhoff and Long cases as authority, rejected plaintiff’s arguments, even though it noted that the decision of the retirement committee “seemed rather severe.” The court held that the retirement plan was a binding contract which specifically abrogated any right to appeal, and that plaintiff, to seek the benefits of the contract, also had to accept its burdens. The court stated that no public policy was offended by the agreement and the only question as to the validity of the retirement committee’s action was whether they acted in good faith, an issue that was resolved by the jury in favor of the defendants.

The approach adopted by the Neuhoff and Bruner cases as to employer-funded private benefit plans is in line with the approach taken in other jurisdictions. Courts have uniformly upheld provisions vesting administration of benefit plans in a committee (usually selected by the employer) and providing that all decisions of the committee, if made in good faith, are final and conclusive on the parties and not subject to judicial review.
The validity of such provisions was crucial in both the principal cases, since the jury found that the plaintiff had not been "dishonest" in *Neuhoff* and was "totally and permanently disabled" in *Bruner* and yet contrary determinations by the committees concerned were upheld.

Despite the fact that these two cases appear to be consistent with case law in Texas and elsewhere, one is left with a feeling of uneasiness after reading them. In *Neuhoff* an employee of twelve years forfeited over $16,000 in benefits for what appears to be a bit of petty graft. It is unlikely that a court would permit a person, by stipulation in an agreement, to impose a forfeiture of this magnitude for such a breach of contract. Such a clause would probably be stricken as unreasonable and therefore a penalty. Similarly, the plaintiff in *Bruner* was denied disability payments even though there was considerable evidence that he was unemployable because of the permanent disabilities he suffered. Employee benefit plans have proliferated in number in the last twenty years, and have become increasingly important as a form of employee compensation. As private benefit plans increase in significance, it is possible that courts ultimately will find it necessary to review the reasonableness as well as the honesty of decisions denying persons benefits on which they relied.25

V. AUTHORITY OF THE PRESIDENT

Writing in 1942, Dean Hildebrand described the Texas law on the inherent authority of the president of a corporation as confusing and unsatisfactory.26 The Texas Business Corporation Act is silent on this question, and the subsequent case law has done little to clear up the confusion. The most recent case on the question, *Nelms v. A & A Liquor Stores, Inc.*,27 while clearly correct on its facts, is entirely consistent with this tradition.

The A & A Liquor Store was incorporated in 1951 with its charter providing for 500 shares of capital stock. Plaintiff John F. Nelms was issued one share and made secretary. His brother, R. C. Nelms, and mother were issued 255 and 243 shares respectively, with his brother becoming president and his mother vice president. In 1955, plaintiff was given a ten-year written contract as general manager. In 1959, plaintiff's employment as general manager was terminated by the corporation, but he continued to act as director and secretary. Plaintiff claimed that he and his brother entered into an oral contract for lifetime employment sometime in 1960. In August 1960, a special board of directors' meeting

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26 2 I. HILDEBRAND, TEXAS CORPORATIONS § 640, at 610 (1942 ed.) [hereinafter cited as HILDEBRAND].

27 443 S.W.2d 216 (Tex. Civ. App.—Eastland 1969), error ref. n.r.e.
set plaintiff's salary at a sum not to exceed $40,000 per year, and for several years he received substantial sums. In 1967, the board adopted a resolution terminating the services of plaintiff but offering to continue him as a consultant for $500 per month, which plaintiff rejected. Plaintiff contended that R. C. Nelms had actual authority as president, director, and majority shareholder to bind the corporation to the contract. Plaintiff also contended that it was not necessary for the oral agreement to be subsequently ratified by the board of directors, since the parties to the contract constituted a majority of the shareholders.

The court rejected plaintiff's contention that a president, director, and majority shareholder had authority to bind the corporation to a lifetime employment contract. The court stated that the authority to employ agents is generally in the board of directors, and the president has no authority by virtue of his office alone to bind the corporation to employment contracts. The court added that if a president is also acting as general manager, he would have the authority to bind the corporation to some employment contracts—but only those which are "usual and necessary" to the management of a particular business. Since general managers do not have the authority to make lifetime employment contracts, the court concluded that the defendant did not have the express, implied, or apparent authority to make such a contract.

There is a conflict of decision on the inherent authority of a president." One view is that the president has no authority by virtue of his office to enter into contracts which are binding upon the corporation." The other view is that the president of a corporation is presumed by his position to have authority to bind the corporation to all contracts which are made in the ordinary course of business. Under this view, only "extraordinary" contracts are outside the president's authority." The Texas cases on the inherent authority of the president do not clearly adopt any view." Some Texas cases indicate the president has no inherent powers, others hold he has some implied power, and still others maintain that he is presumed to have certain powers." The best that can be said is that attorneys should probably assume that in Texas the corporate president has no authority by virtue of his office to enter into contracts binding the corporation."

A restrictive view of the powers of a corporate president has been severely criticized by commentators, the main objection being that such a position is inconsistent with the view which is held by most people of the president's authority." Because most people consider the president of a corporation to be a man of power and responsibility, holding that he...
has no inherent power to make ordinary contracts can result in injustices to innocent third parties. Dean Hildebrand expressed hope that a supreme court decision would overrule the earlier cases and hold at least that a president has the authority to bind his corporation to contracts made in the ordinary course of business. The hoped-for decision has not come, and, as shown by Nelms, the courts of civil appeals continue to describe the inherent authority of the president in very restrictive terms.

Despite the court's unfortunate language, its holding that the lifetime employment contract was not within the authority of the president seems sound. Lifetime employment contracts should be considered truly "extraordinary" since they subject the corporation to a liability which may run for a long and indefinite period during which circumstances may change substantially. There may also be a feeling that oral lifetime employment contracts are inherently implausible. In any event, claims such as that put forth in Nelms have been received with hostility by the courts.

VI. Share Transfer Restrictions

In May v. Wilcox Furniture Downtown, Inc. a corporation sought specific performance of an option to repurchase the shares of a former employee, May. The bylaws of the corporation contained an option provision restricting the transfer of shares: "No shareholder shall dispose of ('meaning to sell, offer for sale, mortgage, encumber, give away or otherwise attempt to affect the title to') the shares owned by him . . . until the shares to be sold have been first offered to this corporation. . . . The price to be paid to the shareholder by the corporation shall be 80% of the book value as determined by the last annual audit." The by-laws also provided that in the event any shareholder should leave the employ of the corporation it was mandatory that he offer his shares to the corporation.

Upon termination of May's employment, demand was made that he surrender his shares. Because the corporation was closely held and there was no market for its shares, May was willing to sell his shares back to the corporation. He refused, however, to accept the corporation's valuation of their worth, which was based on an unaudited financial statement prepared by the corporation's accountant. His basic objection was the manner of accounting for profits from certain long-term installment sales. The corporation used the "installment method" for tax and accounting purposes. This results in the gain on the installment sales

68 See HILDEBRAND § 640, at 610-11.
69 Id. § 640, at 610.
70 See W. FLETCHER, supra note 19, at § 597.1.
72 450 S.W.2d 734 (Tex. Civ. App.—Corpus Christi 1969), error ref. n.r.e.
73 In actuality there were three related corporations as plaintiffs, but for convenience of discussion they will be referred to as if they were a single corporation.
74 450 S.W.2d at 735-36 (emphasis omitted).
75 INT. REV. CODE of 1954, § 453 (a).
being reported only as payments are received. May contended that the "accrual method" of accounting should be used to determine the book value of his shares. Under this method of accounting, gross profits on installment sales of merchandise are recognized as the sales are made, even though part of the purchase price may not have been received. May first requested that the trial court order an audit to determine the book value of his stock. Because the corporation had determined the book value of May's shares on the basis of an unaudited financial statement, rather than an audited one as provided in the agreement, the court appointed a certified public accountant to audit the financial statement of the corporation. Since the option agreement was silent as to which accounting method should be used to determine book value, the court directed that it should be made "in accordance with established and accepted accounting principles." May agreed to be bound by the results of the audit.

The court-appointed auditor audited the books of the corporation using the installment method of accounting, and returned an audit identical to the financial statement prepared by the company's accountant. May then requested that another audit be ordered with the accrual method of accounting being specified by the court. The court ordered the second audit based upon the accrual method—but upon its return, entered judgment based on the first audit. The court of civil appeals agreed that the book value of the shares should be determined from the first audit, using the installment method. The court alternatively held (1) that May was estopped from objecting to the first audit since he had requested it and had agreed to be bound by it, and (2) that the first court-ordered audit was binding on the parties as the "last annual audit" called for in the option agreement. The court also stated that if an annual audit had been prepared prior to the termination of May's employment, it would have been binding on May regardless of which method of accounting had been used in making the audit.7

Share transfer restrictions are expressly authorized by article 2.22 of the Texas Business Corporation Act,8 which further provides that restraints must not "unnecessarily restrain or prohibit transferability." Planning the price provision is the most difficult and important problem involved in drafting share transfer restrictions for closely held corporations.9 The most popular method, and the one used in the May case, is to

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74 450 S.W.2d at 378.
75 Cf. Morrison v. St. Anthony Hotel, 274 S.W.2d 556 (Tex. Civ. App.—Austin 1955), error ref. n.r.e. (when option agreement provided that fair value of assets should be determined by specified auditors, auditors' finding was held binding on the parties in absence of fraud or obvious mistake).
76 TEX. BUS. CORP. ACT ANN. art. 2.22 (Supp. 1970). Prior to passage of the Business Corporation Act, a stock transfer restriction was upheld in Coleman v. Kettering, 289 S.W.2d 913 (Tex. Civ. App.—Galveston 1956) (agreement embodying share transfer restriction held not to be void as against public policy).
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base the price on the "book value" of the shares. As illustrated by the May case, however, the phrase "book value" is deceptively simple, and its routine use may invite costly litigation. Since the term has no single meaning and may vary substantially depending on the accounting methods involved, consideration should be given to specifying in the restriction itself the accounting conventions to be used in computing book value. For example, if the corporation utilizes accelerated depreciation schedules for tax purposes, it may be desirable to specify that straight line depreciation should be used to compute book value. Or, if inventory is valued on a LIFO basis, it may be desirable to require an increase in the value of inventory to a more realistic figure. Further, it should be recognized that book value may be an unreliable guide to the true worth of a going business; it takes no account of goodwill and uses historical cost, rather than current market value, of assets. It therefore may also be desirable to require adjustments, such as valuing readily marketable securities at market value rather than at cost, to make book value a more realistic indicator of true value for purposes of the share transfer restriction. The basic lesson, however, is clear: book value is not a magic figure, and the careful draftsman should not routinely use this method of valuation without considering its underlying factors and the various methods of computation.

VII. MISCELLANEOUS DECISIONS

Two cases during the survey period construed specific provisions in miscellaneous Texas statutes. Article 2226 of the Texas civil statutes provides that attorneys' fees may be awarded to plaintiffs in connection with claims for "personal services rendered" or "labor done." In Tenneco v. Padre Drilling Co. the Texas supreme court held that this statute covered "only those claims for services rendered by the claimant personally." Therefore, a corporation, which can only act through agents or employees, cannot have a claim for "personal services rendered" or "labor done" within the meaning of article 2226. Of course, plaintiff

9 See O'Neal, supra note 77, at 799; Page, supra note 78, at 664.
11 See Bradley, supra note 77, at 157; O'Neal, supra note 77, at 799; Page, supra note 78, at 666-67.
12 Article 2226 authorizes a recovery of attorneys' fees by "any person having a valid claim against a person or corporation for personal services rendered, labor done, material furnished, over-charges on freight or express, or stock killed or injured, or suits founded upon a sworn account or accounts . . . ." Tex. Rev. Civ. Stat. Ann. art. 2226 (1964).
13 453 S.W.2d 814 (Tex. 1970).
14 Id. at 819.
15 In Van Zandt v. Fort Worth Press, 359 S.W.2d 893 (Tex. 1962), the court had left open the question whether a corporation could render personal service within the meaning of art. 2226, but had implied that it could not. Subsequent to the Van Zandt decision, several civil appeals cases gave confusing constructions to art. 2226. The court in the principal case enumerated these decisions and overruled them as being inconsistent with the proper reading of Van Zandt. 453 S.W.2d at 820.
corporations may nevertheless recover attorneys' fees under other parts of this article.

In another case, a court of civil appeals in effect held that an electrical cooperative was incapable of entering into an employment contract with an employee. The basis of this decision is section 23 of the Texas Electric Cooperative Act, which provides that "any officer, agent or employee elected or appointed by the Board, may be removed by it whenever in its judgment the best interests of the corporation will be served." The court found this section to be inconsistent with article 2.43 of the TBCA, which authorizes such contracts. Article 2.43 was, therefore, inapplicable to electric cooperatives. While the case is of limited practical importance, it may indicate a need to reconsider the desirability of retaining the numerous miscellaneous statutes dealing with the internal structure of corporations engaged in specific types of businesses.

_Caldwell v. Kingsberry_ concerned the validity of a shareholders' and directors' meeting at which a minority shareholder in a closely held corporation was removed from office as president and director. The president refused to call a meeting after learning that the majority shareholders planned to oust him, but made the mistake of actually attending the meeting, which apparently was called without giving the notice required by the bylaws. Under the principle of _Camp v. Shannon_, actual attendance constituted a waiver by the shareholders of the defective notice and validated the actions taken at the meeting. The case is a good illustration of the practical difficulties which may be encountered when majority shareholders seek to regain control of the corporation from a person in control who actively seeks to thwart the will of the majority.

VIII. POSTSCRIPT TO THE 1969 SURVEY

In last year's Annual Survey, the Internal Revenue Service's position on corporate tax treatment for professional corporations and associations was discussed. In August 1969, the Internal Revenue Service had announced that it did not plan to continue its court battle against professional corporations and associations. During the current survey period,
The Internal Revenue Service released Revenue Ruling 70-101, which describes the current position of the Service. Generally, the IRS will treat organizations organized under the Texas Professional Corporation Act as corporations for tax purposes. However, the IRS refuses to take the same position with regard to professional associations organized under the Texas Professional Association Act. Such an association may or may not be classified "as a corporation in a given case," depending on whether it qualifies for corporate classification under the pre-1965 regulations. The whole area of employee benefit plans, moreover, is under current study by the Treasury Department, and it is probable that entirely new rules may be established at a later date to supplant Revenue Ruling 70-101.

\[\text{Id. art. 1528f.}\]