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# Corporations -- 1962 Tennessee Survey

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## I. Jurisdiction Over Foreign Corporations—The Solicitation Plus Rule

The extent of Tennessee's assertion of jurisdiction over foreign corporations was considered in *Atchison, Topeka & Santa Fe Ry. v. Oritz*[1] and *Fisher v. Trion, Inc.*[2] by two of the Tennessee courts of appeal. Both cases are of interest because of their respective approaches to the so-called "solicitation plus" rule.

In the *Atchison, Topeka & Santa Fe Ry. v. Oritz* case, the Court of Appeals for the Western Section upheld the assertion of jurisdiction over a foreign railroad corporation by service under Tennessee Code Annotated section 20-218[3] at the office of its "soliciting agent."[4] That case involved an alleged failure to deliver cotton shipped by the plaintiff over the defendant railroad from Cruces, New Mexico, which was destined for Houston, Texas. The plaintiff asserted claims based

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1. 361 S.W.2d 113 (Tenn. App. W.S. 1962), *cert. denied*, Oct. 4, 1962.
2. 353 S.W.2d 406 (Tenn. App. E. S. 1961), *cert. denied*, Dec. 8, 1961. The United States District Court for the Eastern District of Tennessee also deeided two cases involving jurisdiction over foreign corporations: Smith v. Lancer Pools Corp., 200 F. Supp. 199 (E. D. Tenn. 1962), and First Flight Co. v. National Carloading Corp., 209 F. Supp. 730 (E. D. Tenn. 1962). These cases are treated in Cheatham, *Conflict of Laws—1962 Tennessee Survey*, 16 Vand. L. Rev. 646, 647 (1963).
3. *Service at office of corporation.*—When a corporation, business trust, or any person has an officer or agency, or resident director, in any county other than that in which the chief officer or principal resides, the service of process may be made on any agent or clerk employed therein in all actions brought in such county against same growing out of the business of, or connected with, said principal's business; but this section shall apply only to cases where the suit is brought in such counties in which such agency, resident director, or office is located." Tenn. Code Ann. § 20-218 (1956).

A foreign corporation may be subjected to the jurisdiction of the Tennessee courts by service effected under § 20-218 whether or not the cause of action sued upon arose out of the business conducted by such corporation in Tennessee. See Alwood & Greene v. Buffalo Hardwood Lumber Co., 152 Tenn. 554, 560, 279 S.W. 795, 797 (1925). *Cf.* J. W. Hull Plumbing & Heating Co. v. Grand Lodge, 10 Tenn. App. 356, 361-62 (W.S. 1929).

4. 361 S.W.2d at 118.

on contract, the Carmack amendment and negligence.[5]

The defendant railroad had no tracks in Tennessee, but it operated an office in Memphis staffed by two of its employees, a "soliciting agent" and a clerk. The court found that the defendant, through such employees, had authority to issue and had issued "exchange bills of lading" and had gathered information and communicated with potential freight or passenger traffic over the defendant's lines. The court also found that the defendants "execute contracts" in Memphis, but it failed to specify what kind of contracts or how many of such contracts have been executed.[6]

The jurisdictional question before the court was posed by the defendant's plea in abatement which attacked service of process upon it on the basis of the fourteenth amendment and the commerce clause. A demurrer to the plea was sustained; after judgment was awarded to the plaintiff, the defendant appealed, *inter alia*, on the basis of the plea in abatement.[7]

In order to reach the constitutional question posed by the plea, the court had an initial task of statutory construction. In construing section 20-218, the court approved the interpretation which had been adopted in *Ketch v. Atlantic Coast Line R.R.*[8] by the Federal District Court for the Eastern District of Tennessee. In that case, the court interpreted the statutory term "office"[9] as including an office maintained by a railroad soliciting agent and held that the only impediment that might arise with respect to service upon a foreign corporation maintaining such an office would be a constitutional one.[10] In *Tucker v. International Salt Co.*,[11] however, the Tennessee Supreme Court, employing a rationale that appeared to be constitutionally

5. *Id.* at 114. It would appear that the defendant could have challenged the adjudication in Tennessee of a suit based upon the Carmack Amendment. See 24 Stat. 386 (1887), as amended, 49 U.S.C. § 20(11) (1958).

6. The facts are recited in 361 S.W.2d at 118. The court's failure to specify the kind of contracts found to be executed in finding No. 1 raises an inference that such contracts are the exchange bills of lading found to have been executed in finding No. 3. Compare the court's further reference to the execution of contracts in 361 S.W.2d at 122-23, and the court's admission, *id.* at 125, that the facts were "practically similar" to those in Green v. Chicago, B. & Q.R.R., 205 U.S. 530 (1907).

7. 361 S.W.2d at 115.

8. 51 F. Supp. 243 (E.D. Tenn. 1953); *accord*, Turcott v. Yazoo & M.V.R.R., 101 Tenn. 102, 45 S.W. 1067 (1898). *But cf.* Atlantic Coast Line R.R. v. Richardson, 121 Tenn. 448, 457 in which "offices at Nashville, soliciting freight" were held not to make foreign railroad corporations amenable to Tennessee jurisdiction. The Richardson case may be distinguishable, however, because service was on "traveling soliciting agents" and reliance was solely under the predecessor of Tenn. Code Ann. §§ 20-220 to -221.

9. Although the statute uses the term "officer," such term has been interpreted to mean "office." Cumberland Tel. & Tel. Co. v. Turner, 88 Tenn. 266, 267, 12 S.W. 544 (1889); Chicago & A.R.R. v. Walker, 77 Tenn. 475, 479 (1882); Toppins v. E.T., Va. & Ga. R.R., 73 Tenn. 600, 604 (1880).

10. 51 F. Supp. at 245.

11. 209 Tenn. 95, 349 S.W.2d 541 (1961).

based,[12] assumed that section 20-217,[13] a companion jurisdictional section to section 20-218, could not subject a foreign corporation to the jurisdiction of the Tennessee courts unless such corporation was "doing business"[14] in Tennessee; the court held that the satisfaction of the doing business requirement would be tested by the "solicitation

12. See *id.* at 544-45. See Morgan & Handler, *Procedure and Evidence—1961 Tennessee Survey (II)*, 15 VAND. L. REV. 921, 934-35 (1962).

13. "*Service on corporate officers.*—Service on the president or other head of a corporation, or, in his absence, on the cashier, treasurer, or secretary, or, in the absence of such officers, on any director of such corporation, shall be sufficient. If the action is commenced in the county in which the corporation keeps its chief office, the process may be served on any one of the foregoing officers, in the absence of those named before him. If neither the president, cashier, treasurer, or secretary resides within the state, service on the chief agent of the corporation, residing at the time in the county where the action is brought, shall be sufficient." TENN. CODE ANN. § 20-217 (1956).

Although the *Tucker* court was concerned with § 20-220 as well as with § 20-217, the language of the opinion indicates that the court considered § 20-220 for the purpose of ascertaining whether the implied doing business requirement in § 20-217, see note 14 *infra*, could be met by satisfying the § 20-220 doing business definition. See 209 Tenn. at 99-100, 349 S.W.2d at 543.

14. It would appear that the litigants, as well as the court, assumed the existence of a "doing business" requirement. See 209 Tenn. at 99, 349 S.W.2d at 543. The court used "presence" interchangeably with "doing business." 209 Tenn. at 102-05, 349 S.W.2d at 544-45.

In interpreting the predecessors of §§ 20-217, 20-218, Tennessee decisions prior to the *Tucker* case had indicated that such provisions applied to foreign corporations which were "doing business" in Tennessee. See, *e.g.*, J. W. Hull Plumbing & Heating Co. v. Grand Lodge, 10 Tenn. App. 356, 361-62 (W.S. 1930); Chicago & A.R.R. v. Walker, 77 Tenn. 475, 478-79 (1882); Alwood & Greene v. Buffalo Hardwood Lumber Co., 152 Tenn. 544, 551, 279 S.W. 795, 797 (1925). *Cf.* Wrought Iron Range Co. v. D. W. DeVault, 6 Tenn. App. 513, 520-21 (E.S. 1922) (construing predecessor of § 20-218 and commingling interpretation of "office" with "doing business"). It is interesting to note that the "doing business" condition which surrounded the jurisdictional question was found not only in now obsolescent United States Supreme Court opinions construing the fourteenth amendment, *e.g.*, International Harvester Co. v. Kentucky, 234 U.S. 579, 583 (1914), and in state court jurisdictional decisions, but also after 1891 had a possible statutory reference. Chapter 122 of the Acts of 1891 provided that every foreign corporation "which may desire to do any kind of business in this State" in order to "carry on business" in Tennessee had to qualify and upon qualification was declared to be "subject to the jurisdiction of the courts of this State just as though it were created under the laws of this State." Chapter 81 of the Acts of 1895 amended the Act of 1891 to require qualification before a foreign corporation should "do business, or attempt to do business, in this State" and provided that upon qualification such corporation would be "subject to the jurisdiction of this State as fully as if created under the laws of the State of Tennessee." As applied subsequent to 1891 to corporations which had qualified, therefore, the predecessors of §§ 20-217 and 20-218, provided a method of serving corporations which were already subject to the jurisdiction of the Tennessee courts under the Acts of 1891 or 1895; a similar analysis might possibly have been applied to corporations which were obligated to qualify but had not done so. *Cf.* Radford v. Minnesota Mining & Mfg. Co., 128 F. Supp. 775 (E.D. Tenn. 1955). Although it is unclear whether chapter 13 of the Acts of the Extra Session of 1929 (Tenn. Code Ann. §§ 48-901 to -912) repealed by implication all of the provisions of the Acts of 1891 and 1895 quoted above, *cf.* Crenshaw v. Texakola Pecan Shellers, Inc., 171 Tenn. 273, 280, 102 S.W.2d 60, 63 (1937), a reading of §§ 20-217 and -218 which would relate them to present qualification provisions might restrict the reach of the former sections over unqualified corporations to causes of action plus" rule.[15] While it is far from clear whether the *Oritz* court viewed *Tucker* as a case interpreting the fourteenth amendment or as a case of statutory construction, there are some indications in the *Oritz* opinion that it chose to interpret *Tucker* as a case of statutory construction only.[16] In any event, by taking note[17] of the language in *Tucker* which adverted[18] to an erosion of the solicitation plus rule,[19] the *Oritz* court interpreted *Tucker* as doing no more, from the standpoint of either constitutional interpretation or statutory construction, than requiring the application of an eroded form of that rule.[20]

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arising out of business done in Tennessee. See TENN. CODE ANN. § 48-923 (Supp. 1962).

15. 209 Tenn. at 101-05, 349 S.W.2d at 543-45. The "solicitation plus" rule was a test for measuring the scope of a state's assertion of jurisdiction over a foreign corporation. If the foreign corporation was engaged only in solicitation within a state, the foreign corporation was not subject to the jurisdiction of the courts of that state. If the foreign corporation engaged in activities in addition to "mere solicitation," however, then it could be subjected to that state's jurisdiction. See Morgan & Handler, *Procedure and Evidence—1961 Tennessee Survey (II)*, 15 VAND. L. REV. 921, 934-35 (1962). *Cf.* the reference in United States v. Scophony Corp., 333 U.S. 795, 807-08 (1948) to "hair-splitting legal technicalities" which had emerged under the solicitation plus rule. The rule has been used both as a fourteenth amendment measure of state court jurisdiction and as a state-law measure of jurisdiction.

16. The court described *Tucker* as a case which "discusses the meaning and application to the facts as stated there of our T.C.A. § 20-217 and T.C.A. § 20-220 . . . ." 361 S.W.2d at 121, and further noted that International Shoe Co. v. Washington, 326 U.S. 310 (1945), referred to in the *Tucker* opinion, "had a different question," *i.e.*, a fourteenth amendment question, "from the case of Tucker v. International Salt Company." 361 S.W.2d at 123.

17. 361 S.W.2d at 122.

18. 209 Tenn. at 105, 349 S.W.2d at 545.

19. See Frene v. Louisville Cement Co., 134 F.2d 511 (D.C. Cir. 1943) which contains Justice Rutledge's now classic description of the erosion of the solicitation plus rule.

20. As applied to railroad solicitation offices, the solicitation plus rule has never been very strong. Continuous negotiations with respect to settlement of claims of shippers had been held sufficient activity to constitute the "plus" that would validate the assertion of jurisdiction at an early date, even though it would appear that in the case so holding none of the persons attached to the office involved had any authority to settle claims other than through persuasion. St. Louis S.W. Ry. v. Alexander, 227 U.S. 218, 228 (1913); *accord*, Missouri, K. & T. Ry. v. Reynolds, 255 U.S. 565 (1921). Since many of the railroad solicitation offices which have been involved in litigation have engaged in at least this amount of "plus" activity, jurisdiction has often been upheld. Canadian Pac. Ry. v. Sullivan, 126 F.2d 433, 438 (1st Cir. 1942); Moore v. Atlantic Coast Line, 98 F. Supp. 375 (E.D. Pa. 1951). *Cf.* Willett v. Union Pac. R.R., 76 F. Supp. 903 (N.D. Ohio 1948). Compare Wadell v. Green Textile Associates, Inc., 92 F. Supp. 738 (D. Mass. 1950); Isenberg v. Atlantic Coast Line, 82 F. Supp. 927 (D. Mass. 1949). See also note 29 *infra*. *But see* Kelley v. Delaware, L. & W.R.R., 170 F.2d 195 (1st Cir. 1948); Smith v. Louisville & N.R.R., 90 F. Supp. 189 (S.D.N.Y. 1950); Fiorella v. Baltimore & O.R.R., 89 F. Supp. 850 (E.D. Pa. 1950); Goldstein v. Chicago, R.I. & P.R.R., 93 F. Supp. 671 (W.D.N.Y. 1950); Zuber v. Pennsylvania R.R., 82 F. Supp. 670, 675 (N.D. Ga. 1949); Doyle v. So. Pac. Ry., 87 F. Supp. 974 (E.D. Mo. 1949); Murray v. Great N. Ry., 67 F. Supp. 944 (E.D. Pa. 1946); Worthy v. Louisville & N.R.R., 79 N.Y.S.2d 588 (Sup. Ct. 1948), *aff'd*, 276 App. Div. 1068, 96 N.Y.S.2d 489 (1950). The basis on which the foregoing decisions interpreted the solicitation plus rule varied. In some cases the rule was applied as a

It distinguished *Tucker* on its facts:[21] it said that the instant case involved a fixed office, a secretary attached to such office, and an agent attached to the office who possessed the power to contract for his principal, such factors apparently constituting the "plus" elements required under *Tucker* to sustain jurisdiction. In dealing with *Green v. Chicago, Baltimore & Quincy Ry.*,[22] the leading authority with respect to the solicitation plus rule, the court admitted that the facts in the instant case were "practically similar"[23] to the facts in *Green*, but suggested that the *Green* case had undergone substantial erosion in the years subsequent to its promulgation. The court held that even if *Green* were relevant to the interpretation of section 20-218[24] or to the fourteenth amendment,[25] however, the instant case was distinguishable from *Green* because of the fact that Memphis, the city in which the solicitation office was located, is situated near a large water and rail terminal.[26] The court concluded that because a large amount of the freight carried by water to Memphis is reshipped by rail to all parts of the nation, it was "good business judgment"[27] for the defendant to maintain an office in Memphis. The court's distinction seems weak inasmuch as it is not immediately apparent how much more strategic a location the Memphis water and rail terminal is than the Philadelphia water and rail terminal was at which the soliciting office involved in the *Green* case was located.[28] Moreover, it would seem that if the board of directors of any railroad corporation has been performing its functions properly, each solicitation office established by that railroad will have been established with "good business judgment." The court's distinction would thus seem to be less of a distinction of *Green* than of an illustration of the erosion of the solicitation plus rule. As a precedent, *Oritz* might have spoken with greater clarity if it had either expressly rejected *Green* in the railroad solicitation context,[29] or if, in its use of the

matter of state law; in other cases the rule was applied as a fourteenth amendment limitation on the scope of state court jurisdiction; in other cases the rule was applied as a measure of the extent of federal service of process.

21. 361 S.W.2d at 122.

22. 205 U.S. 530 (1907).

23. 361 S.W.2d at 125.

24. The court noted that *Green* was concerned with "the rule goveruing doing business within the [federal court] district" and indicated that *Green* might be relevant if such rule "is the same as that required by our state statute." *Ibid.*

25. The court also dealt with *Green* from a constitutional standpoint. 361 S.W.2d at 125.

26. *Id.* at 126-27.

27. *Id.* at 127.

28. 205 U.S. at 532. Philadelphia is an important port, the headquarters of the Pennsylvania Railroad, and the seat of large terminal facilities maintained by the Baltimore and Ohio Railroad and the Reading Railroad.

29. *Cf.* the following cases dealing with railroad solicitation offices, which, in varying legal contexts, contain language indicative of the abandonment of the

strategic location factor, it had caused a factual inquiry to be made with respect to how strategic the Memphis location is in dollar amounts of goods being shipped through Memphis and the dollar amounts of such goods that ultimately find their way to the defendant's railway.

Other parts of the *Oritz* opinion relating to jurisdiction are unsatisfactory. The court's handling of *International Shoe Co. v. Washington*,[30] *McGee v. International Salt Co.*,[31] and *Napelbaum v. Atlantic Greyhound Corp.*[32] left much to be desired. Moreover, the court's failure[33] to cite any cases in support of its decision against the commerce clause contention of the defendant is not conducive to imparting an understanding of the legal basis for the court's ruling.

Whether the *Oritz* result is a good one is open to doubt. The opinion is a praiseworthy attempt to limit the Tennessee Supreme Court's endorsement of the solicitation plus rule in the *Tucker* case. The lack of reported facts concerning the defendant's economic and

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solicitation plus rule: Edwards v. Atlanta & W.P.R.R., 197 F. Supp. 686 (E.D.N.Y. 1961); Perkins v. Louisville & N.R.R., 94 F. Supp. 946, 951 (S.D. Cal. 1951). *Cf.* Lone Star Package Car Co. v. Baltimore & O.R.R., 212 F.2d 147 (5th Cir. 1954); Allegue v. Gulf & S.A.S.S. Co., 103 F. Supp. 34 (S.D.N.Y. 1952); Kendrick v. Seaboard A.L.R.R., 98 F. Supp. 372, 373 (E.D. Pa. 1949).

30. 326 U.S. 310 (1945). The court appeared content to explain the *International Shoe* case as involving a fourteenth amendment question and therefore "a different question" from the question before the Tennessee Supreme Court in *Tucker v. International Salt Co.*, 361 S.W.2d at 123. Although a fourteenth amendment question was before the *Oritz* court, that court did not cite the *International Shoe* case in support of its decision on the constitutional issue, except as citations of *International Shoe* appear in excerpts from other cases quoted by the court.

31. 355 U.S. 220 (1957). Although the court thought that *McGee* supported its decision on the constitutional issue, it failed to point out that *McGee* involved a cause of action arising from activities of the defendant which were connected with the forum state. This distinction would seem to take much force out of the court's rhetorical question, 361 S.W.2d at 124.

32. 171 F. Supp. 547 (S.D.N.Y. 1958). The court quoted a lengthy excerpt from the *Napelbaum* opinion in which the Federal District Court for the Southern District of New York suggested a number of criteria which it said should be considered in deciding questions of jurisdiction over foreign corporations. Despite the fact that the third, fourth and fifth criteria proposed in the *Napelbaum* opinion were, respectively, whether the defendant's activities in the forum gave rise to the cause of action, whether the forum has some special interest in granting relief, and the relative conveniences of the parties, the court stated that in applying the five criteria to the activities of the defendants "we still can hardly see how the defendant can escape submitting to the jurisdiction of the Courts of the State of Tennessee." 361 S.W.2d at 126. Since the third *Napelbaum* criterion points away from the assertion of jurisdiction, and the non-residency of both plaintiffs and defendants would seem to cause the fourth and fifth criteria also to point against such assertion, it would seem that in reaching the result that it did, the court should have rejected the *Napelbaum* opinion.

33. In describing the defendants' contentions, the court cited the three cases relied upon by the defendants, all of which tended to support the defendants' contention of lack of jurisdiction: Denver & R.G.W.R.R. v. Terte, 284 U.S. 284 (1932); Mich. Cent. R.R. v. Mix, 278 U.S. 492 (1929); Davis v. Farmer's Co-op. Equity Co., 262 U.S. 312 (1923).

other connections with Tennessee makes it hard to evaluate the fairness of subjecting the foreign railroad corporation to the jurisdiction of the Tennessee courts in an action unconnected with the activities of its Tennessee soliciting office, especially when the nonresidency of the plaintiffs seemingly evidences a lack of special interest by Tennessee in the prosecution of the suit. As a result it is hard to determine both the compatability of the result with fourteenth amendment due process limitations[34] and the wisdom of the result as evidencing a construction of section 20-218.[35] Although some United States Supreme Court decisions would indicate that the defendant's commerce clause contention had much merit to it,[36] those decisions all predate *International Shoe v. Washington* and evidence a substantial degree of conceptual rigidity;[37] it may be that the flexible due process standards which have developed as a result of the latter case are similarly to be applied in interpretation of the commerce clause.[38]

The *Trion* case dealt with Tennessee Code Annotated sections 20-220[39] and 20-221[40] which subject foreign corporations to the

34. Fourteenth amendment limitations on state assertions of jurisdiction would appear to be described primarily in terms of fairness. See International Shoe Co. v. Washington, 326 U.S. 310 (1945). The fairness of subjecting a foreign corporation to suit in a state court would seem to be related to the nexus between the corporation and the state asserting jurisdiction over it. The economic components of that nexus, accordingly, would seem highly relevant to an evaluation of the constitutional validity of the asserted jurisdiction.

35. In addition to the notions of fairness which should probably be read into the state jurisdictional statutes, it would seem that, in the interest of the state, restrictions on the exercise of jurisdiction should be read into such statutes to the extent necessary to prevent foreign corporations from being discouraged from establishing or maintaining economic ties with Tennessee. Compare National Beverage Co. v. W.J. Bush & Co., 6 Tenn. Civ. App. 643, 654 (1916). If the courts are not to overcompensate for the discouragement factor, however, an inquiry into the kind and degree of relationship maintained by a foreign corporation with Tennessee would be revelant. Thus no purpose would be served in exempting from Tennessee jurisdiction a foreign corporation which maintains such profitable economic ties with Tennessee that it would be in such corporation's interest to continue to maintain and to expand those ties whether or not such an exemption were granted.

36. See cases cited note 33 *supra* and International Milling Co. v. Columbia, 292 U.S. 511 (1934), all of which place substantial emphasis on the plaintiff's residence. *But cf.* Wadell v. Green Textile Associates, Inc., 92 F. Supp. 738 (D. Mass. 1950).

37. The Supreme Court's tests of whether an undue burden on interstate commerce existed centered around the domicile or residence of the plaintiff, the business operations of the defendant, and the place where the canse of action arose. The Court expressly refused to consider questions of inconvenience or availability of witnesses, and did not inquire into the extent of the burden imposed on commerce in terms of dollar amounts. Denver & R.G.W.R.R. v. Terte, *supra* note 33, at 287-88.

38. Compare *Developments in the Law—State-Court Jurisdiction*, 73 HARV. L. REV. 909, 985-86 (1960).

39. *"Foreign corporations subject to actions.*—Any corporation claiming existence under the laws of the United States or any other state, or of any country foreign to the United States, or any bnsiness trust found doing business in this state, shall be subject to suit here to the same extent that corporations of this state are by the laws thereof liable to be sued, so far as relates to any transaction had, in whole or in part, within this state, or any cause of action arising here, but not otherwise. Any such

jurisdiction of the Tennessee courts "so far as relates to any transaction had, in whole or in part, within this state, or any cause of action arising here" and authorize service "upon any agent of said corporation . . . no matter what character of agent such person may be." Section 20-220 contains an express "doing business" requirement and its own apparently non-exclusive definition of doing business. The section 20-220 doing business requirement is met with respect to a corporation which has "any transaction with persons, or . . . any transaction concerning any property situated in this state, through any agency whatever, acting for it within the state."

The defendant in *Trion*, a foreign corporation, produced air cleaning equipment, which it sold in Tennessee through manufacturer's agents or brokers.[41] When one of the plaintiffs inquired by letter to the defendant about certain equipment produced by it, the defendant replied that it would ask its local manufacturer's representative to assist with the equipment and suggested to its representative that the latter purchase such equipment for resale to the plaintiff.[42] The representative contacted the plaintiffs, received an order for the equipment, purchased the equipment from the defendant and resold it to the plaintiffs. When the equipment caught fire the plaintiffs sued the manufacturer.[43]

On such facts the court of appeals indicated that the defendant had not done business in Tennessee apart from the broad section 20-220

corporation or trust having any transaction with persons, or having any transaction concerning any property situated in this state, through any agency whatever, acting for it within the state, shall be held to be doing business here within the meaning of this section." Tenn. Code Ann. § 20-220 (1956).

40. "*Service on foreign corporations.*—Process may be served upon any agent of said corporation or trust found within the county where the suit is brought, no matter what character of agent such person may be; and, in the absence of such an agent, it shall be sufficient to serve the process upon any person, if found within the county where the suit is brought, who represented the corporation at the time the transaction out of which the suit arises took place, or, if the agency through which the transaction was had, be itself a corporation or business trust, then upon any agent of that corporation or trust upon whom process might have beeu served if it were the defendant. The officer serving the process shall state the facts, upon whom served, etc., in his return; and service of process so made shall be as effectual as if a corporation of this state were sued, and the process has been served as required by law; but, in order that defendant corporation or trust may also have effeetual notice, it shall be the duty of the clerk immediately to mail a copy of the process to the home office of the corporation or trust, by registered return-receipt letter, the postage and fees for which shall be taxed as other costs. The clerk shall file with the papers in the cause a certificate of the fact of such mailing, including the receipt for such letter if one, and make a minute thereof upon the docket, and no judgment shall be taken in the case until thirty (30) days after the date of such mailing." Tenn. Code Ann. § 20-221 (1956).

41. 353 S.W.2d at 408.

42. *Id.* at 409.

43. *Ibid.* The opinion is silent as to whether the plaintiff's claim was based on warranty or negligence.

definition of doing business.[44] In deciding whether the defendant had done business within the meaning of that section's definition, the court used the term "agency" in section 20-220 and the term "agent" in section 20-221 interchangeably.[45] It concluded that since the transaction with the plaintiffs was effected by a sale from the defendant to its representative followed by a resale to the plaintiffs, the representative sold for its own account; since the representative "was not [the defendant's] agent, either actual or apparent, for the transaction with the plaintiffs" the defendant could not be subjected to suit in Tennessee by service on its representative.[46]

Although section 20-220, through its doing business definition,[47] provides for the exercise of jurisdiction over any foreign corporation with respect to a cause of action arising from a single transaction with persons, or concerning property, in Tennessee, in order that such corporation fall within this single transaction provision, the transaction, at least in part, must have been "through any agency whatever, acting for it within the state." The agency qualification made it difficult for the court in the instant case to find that the defendant had fulfilled the terms of the definition, since a purchase for resale

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44. The court appeared to be dealing with the doing business question apart from the § 20-220 doing business definition when it cited and quoted from two A.L.R. annotations on the subject of doing business and cited Banks Grocery Co. v. Kelley Clarke Co., 146 Tenn. 579, 243 S.W. 879 (1922), although the latter case construed the phrase "doing business" in the context of the predecessor of § 20-220. The court's citation of Interstate Amusement Co. v. Albert, 128 Tenn. 417, 161 S.W. 488 (1913); Lummus Cotton Gin Co. v. Arnold, 151 Tenn. 540, 269 S.W. 706 (1925); and Bouldin v. Taylor, 152 Tenn. 97, 275 S.W. 340 (1925) appears to evidence the court's feeling that the "doing business' standard relevant to an assertion of jurisdiction under the service of process provisions of the Tennessee Code is the same as the standard under the qualification of foreign corporations provisions. Compare note 14 *supra. But cf.* State v. Connecticut Mut. Life Ins. Co., 106 Tenn. 282, 294, 61 S.W. 75, 77 (1901).

45. 353 S.W.2d at 408-09. Compare the language from the opinion quoted in note 46 *infra,* with the court's description of the plaintiff's contention, "that Rogers was the *agent* of the defendant Trion, Inc., for the transaction with Fischer and that the service of process in this case was therefore valid." 353 S.W.2d at 408. (emphasis is the court's.) In both instances the court's language contains an inference that the terms "agency" and "agent" as used in §§ 20-220 and 20-221 have the same meaning. The cases, however, would indicate that it is harder to fulfill the § 20-220 "agency" than to fulfill the section 20-221 "agent." Such a difference would be expectable, since § 20-221 merely designates the proper person to receive service of process on behalf of corporations which § 20-220 has already made subject to the jurisdiction of the Tennessee courts.

46. "Having concluded . . . that the defendant, Trion, Inc., was not doing business within this state within the meaning of T.C.A. § 20-220 at the time of the sale of its equipment to the plaintiffs, and that Rogers was not its agent, either actual or apparent, for the transaction with the plaintiffs, we are of the opinion that the trial court properly sustained the defendant's plea in abatement to the service of process." 353 S.W.2d at 409.

47. "Any such corporation or trust having any transaction with persons, or having any transaction concerning any property situated in this state, through any agency whatever, acting for it within the state, shall be held to be doing business here within the meaning of this section." TENN. CODE ANN. § 20-220 (1956).

does not fit the common law conception of an agent or agency.[48]

Fulfillment of the doing business requirement other than through the doing business definition might have been possible, however, if the court had felt free to re-evaluate the meaning of the doing business requirement and to restate it in terms of an interest analysis.[49] Although the recent assumption by the Tennessee Supreme Court in *Tucker v. International Salt Co.*[50] that section 20-217 could not subject a foreign corporation to the jurisdiction of the Tennessee courts unless that corporation were "doing business" in Tennessee and the *Tucker* holding that such "doing business" requirement was to be measured in terms of the "solicitation plus" rule[51] would have hindered the instant court from making such a revaluation, the *Tucker* case appears to have applied the doing business and solicitation plus requirements under an assumed constitutional compulsion.[52] Since the instant case involved a cause of action more closely related to the defendant's nexus with Tennessee than did the *Tucker* cause of action as presented to the Tennessee Supreme Court on stipulation,[53] the constitutionality of subjecting the defendant in the present case to the jurisdiction of the Tennessee courts is less open to doubt.[54]

The absence of any citations of United States Supreme Court opinions in the *Trion* case may indicate that *Trion* was based upon considerations of local policy.[55] The absence of any discussion in the

48. Although the existing case law is opposed to such an interpretation, National Beverage Co. v. W. J. Bush & Co., 6 Tenn. Civ. App. 643, 653-54 (1916); but *cf.* Atlantic Coast Line R.R. v. Richardson, 121 Tenn. 448, 458 (1908), a re-evaluation of the meaning of the term "agency" in the light of current jurisdictional concepts might cause a court to conclude that such term included a soliciting agent. Under such a construction of the term, the defendant in the instant case would have been liable under § 20-220 if it had made the sale directly to the plaintiffs, with the intervention of the representative in the capacity of a soliciting agent.

The interpretation of the § 20-220 term "agency" as including a soliciting agent would appear to have some support in the history of that section. The provisions of §§ 20-220 and 20-221 were adopted in 1887 as a response to Chicago & A.R.R. v. Walker, 77 Tenn. 475 (1882) which bad held that a traveling soliciting agent was not an agent within the meaning of "agent" as used in the predecessor of § 20-218. In the *Walker* case, the plaintiff sued for breach of an agreement reached with the defendant's soliciting agent with respect to traveling accommodations on the defendant's railroad, which was entirely without the state. Although the defendant had purchased a ticket on that railroad within Tennessee, he purchased it from a local railroad office rather than from the soliciting agent. Such history would indicate that a soliciting agent is an "agent" within the § 20-221 service of process provisions and that possibly such an agent would be an agency within the meaning of the § 20-220 doing business definition.

49. Morgan & Handler, *Procedure and Evidence—1961 Tennessee Survey (II)*, 15 VAND. L. REV. 921, 935 (1962).

50. 209 Tenn. 95, 349 S.W.2d 541 (1961).

51. See notes 14, 15 *supra* and accompanying text.

52. See note 12 *supra* and accompanying text.

53. 209 Tenn. at 100, 349 S.W.2d at 541.

54. See Cheatham, *Conflict of Laws—1961 Tennessee Survey (II)*, 15 VAND. L. REV. 843, 844 (1962). See also *Developments in the Law—State-Court Jurisdiction*, 73 HARV. L. REV. 909, 928-30 (1960).

55. *Cf.* Morgan & Handler, *supra* note 48, at 935 n.51 where the suggestion is made

opinion, however, of such considerations makes the present decision an unsatisfactory one. In a case like *Trion* in which Tennessee would appear to have an obvious interest in facilitating the adjudication of a claim of two of its residents with respect to harm which occurred in Tennessee,[56] the principal factors militating against the assertion of jurisdiction would be the hardships imposed upon the foreign corporation in defending away from home and the perhaps more far reaching result that such a decision would entail, the increase in the number of suits brought against such corporation by ultimate purchasers of its products whose burden in bringing suit would be eased by such a decision. Since part of such hardships will be economic, it would appear that an examination of the dollar amounts of the defendant corporation's products sold in Tennessee, the amounts of such corporation's profits derived from Tennessee sources and the financial impact that subjecting such corporation to the jurisdiction of the Tennessee courts in this and other like cases would have upon it would be relevant in assessing the extent of that hardship.[57]

## II. Corporate Promotions

*Community General Hospital, Inc. v. Diehl*[58] involved an unsuccessful promotion of a hospital corporation. A preferred stockholder had brought a class action[59] in the Chancery Court of Shelby County for the appointment of a receiver to carry out the dissolution of the corporation and for the cancellation of common stock which the directors had issued to themselves. The chancellor granted both requests; on appeal from his decision cancelling the common stock,[60] the Court of Appeals for the Western Section affirmed. The bases of the decision were, first, that the issuance of the stock constituted a breach of a fiduciary duty owed by the directors to the preferred stockholders,[61] second, that the representations in the prospectus had deceived the preferred stockholders into believing that the directors

that the failure of the *Tucker* court to cite Banks Grocery Co. v. Kelley-Clarke Co., 146 Tenn. 579, 243 S.W. 879 (1922), a leading Tennessee case applying the "solicitation plus" rule, strengthens the probability that the *Tucker* court applied that rule on the basis of federal constitutional considerations rather than on the basis of state policy. The *Trion* court cited *Banks* and did not cite United States Supreme Court opinions.

56. *But cf.* Denson v. Webb, 23 Tenn. App. 599, 136 S.W.2d 59 (W.S. 1938).

57. See note 35 *supra*. Compare Uniform Interstate and International Procedure Act § 1.03(a)(4).

58. 360 S.W.2d 935 (Tenn. App. W.S. 1962).

59. See note 78 *infra*.

60. The appointment of a receiver was not appealed. However, the court indicated that its decision with respect to the cancellation order would determine the validity of the receiver's appointment. 360 S.W.2d at 939-40.

61. *Id.* at 951.

would not be issued such stock for their own benefit,[62] and third, that there had been a failure of the consideration for which the stock was issued.[63]

The corporate charter provided for 348,000 shares of $10 par value preferred stock (the funds from the sale of which, together with funds to be borrowed, were to constitute the basic source of the project's financing) plus 1,200,000 shares of $.01 par value common stock. The common stock apparently possessed exclusive voting rights except during periods in which default had been made in the payment of preferred dividends, at which times the voting power was to be shared between the common and the preferred; even during such periods, however, the common shares would continue to possess the power of control if the number of outstanding shares of common was greater than that of outstanding preferred.[64]

At their initial meeting, the incorporators unanimously resolved that the common stock be subscribed at par by the directors, who would in turn pay for such stock " 'in their services in promoting the Corporation, planning and aiding in the sale of the stock. . . .' "[65] Such resolution provided, however, that the stock " 'should not be issued to the subscribers until the completion or abandonment of the promotion.' "[66] The incorporators also resolved that the directors, by majority vote, could use " 'so much of the common stock as might be advisable' " in promotion, bonuses for salesmen, and other purposes in connection with the promotion and with commencing business operations.[67] Three of a total of four formal prospectuses issued by the directors contained statements[68] to the effect that (i) the directors had subscribed for all the common shares at par and had agreed among themselves to use "said stock" in promotion and sale of the preferred shares and for other promotional and incentive purposes, and (ii) " 'the limit of expenses of promotion is $1.50[69] per unit and

62. *Id.* at 951-52.
63. *Id.* at 953.
64. *Id.* at 945.
65. *Id.* at 944.
66. *Ibid.* The resolution also provided that the directors should be reimbursed after the promotion period for expenses advanced by them and that " 'a continuation of the promotion be a condition of participation in the stock subscription.' " 360 S.W.2d at 944-45.
67. *Id.* at 944.
68. The statements were contained in prospectuses dated February 1, 1958, March 1, 1958, and July 1, 1958. Such statements were as follows: "The Directors subscribed for all the common shares, at par, and have agreed among themselves to use said stock in promotion and sale of the preferred shares, sales incentives for salesmen, obtaining key men in promotion and as incentive awards to obtain key personnel in operating the hospital. . . . The limit of expenses of promotion is $1.50 per unit. No officer or agent shall receive any salary during the promotion except within the expense allowed and provided above.' " *Id.* at 941.
69. The chancellor found that the prospectus statement referred to a promotion

that no officer or agent shall receive any salary or compensation during the promotion except within the expense allowed.'"[70] At a date when the directors apparently were still attempting to promote the sale of the preferred stock but on which date the court found that the promotion "'was then dead and incapable of resurrection,'"[71] the directors resolved to issue fifty-six per cent of the common stock of the corporation to themselves. It was apparently admitted that such shares were issued "for services rendered and to be rendered the corporation";[72] the directors' resolution indicated that these "services" were promotional in nature.[73] Subsequently, the stockholders voted to discontinue the sale of the corporation's stock and to sell the corporate property for the highest price obtainable;[74] the proceeds apparently were intended for either a distribution in liquidation or the construction of a hospital smaller than that which had originally been planned.[75]

In referring to "a breach [by the directors] of their 'fiduciary duty' owing to the persons who had purchased preferred stock in this corporate entity,"[76] the court did not make clear the precise duty to which it referred, although it would appear that the court felt the breach of duty consisted of the directors' issuance of the common stock to themselves beneficially without the knowledge or consent of the preferred stockholders.[77] The court's references to "deception"[78]

expense limitation of $1.20 per unit. *Id.* at 945. The court of appeals gave no explanation for the discrepancy.

70. *Id.* at 941.

71. *Id.* at 946.

72. *Id.* at 940.

73. *Id.* at 947.

74. *Id.* at 948.

75. *Id.* at 939, 946.

76. *Id.* at 951.

77. *Ibid.* Directors and promoters are considered to be under a fiduciary duty to their corporation not to issue stock to themselves for inadequate consideration without the consent of all of the other stockholders. *Cf.* Old Dominion Copper Mining & Smelting Co. v. Bigelow, 203 Mass. 159, 89 N.E. 193 (1909).

78. 360 S.W.2d at 942, 951. The manner in which the court utilized the term "deception" in its opinion would indicate that it was not suggesting that the defendants were guilty of common law deceit. The court seems expressly to have found an absence of scienter. *Id.* at 942. Moreover, the first reference to deception was stated in terms of a possibility of deception. *Ibid.* Finally, it is unclear from the opinion how those preferred stockholders who purchased their stock in the period from the commencement of the preferred stock sale on November 5, 1956, *id.* at 945, until February 1, 1958, the date of the first prospectus, *id.* at 941, could be deceived by representations in such prospectus. Although the chancellor made reference to "'other available informative matter,'" *id.* at 947, the court of appeals referred only to the prospectuses when speaking of deception or possible deception. Although the broad anti-fraud provisions of the Tennessee Securities Law, TENN. CODE ANN. § 48-1644(B) (1956), might have been of assistance in supporting a cause of action for deception falling short of the requirements of common law deceit, the failure of the defendants' conduct to amount to deceit and the court's omission to refer to § 48-1644(B) suggest that the references to deception should be interpreted as suggested in text. The interpretation

appear to be related to this breach of duty, since the lack of knowledge of the preferred stockholders may have partially resulted from the use in three prospectuses of misleading language concerning the plans of the directors with respect to the issuance of common stock. One difficulty with the court's approach, however, lies in the fact that it is not easy to pinpoint the manner in which the director's action injured the preferred stockholders. Because the claim of the preferred stockholders to earnings was both prior and limited, the issuance of the common stock by the directors to themselves could not have diluted the earnings equity of the preferred stockholders.[79] Similarly, the issuance of the common stock could not have jeopardized the preferred stockholders' prior right to receive, on liquidation, all of the corporation's assets up to the ceiling of the preferred's liquidation claim; and with regard to assets in excess of such ceiling, the preferred stockholders were unconcerned.[80] Since the chancellor found that "'one share of common stock . . . went with the sale of each share of preferred stock to the public,'"[81] it is possible that the court permitted the preferred stockholders to sue because their equities as common stockholders had been diluted by the directors' action.[82] The court's silence on this point suggests that the matter was not considered. If the breach of duty was not related to the dilution of the common stock equities but consisted of a shrinkage in the cushion of common capital[83] to which the holders of preferred were entitled, clarity would have been served by the court's enunciation of such fact.[84] The court's reference to "a breach of fiduciary

suggested in text would also avoid certain problems which might arise in a class action based on misrepresentations. *Cf.* 3 MOORE, FEDERAL PRACTICE ¶ 23.10[5] (1948).

79. *Cf.* Jeffs v. Utah Power & Light Co., 136 Me. 454, 470, 12 A.2d 592, 600 (1940): "The preferred stockholders . . . had no interest in the share of the corporate assets of those holding securities junior to theirs, nor in the earnings which might accrue over and above the amount necessary to satisfy the dividends on the preferred stock. . . . A plaintiff, who can show no injury to himself . . . surely has no standing in court"; Berle, *Compensation of Bankers and Promoters Through Stock Profits*, 42 HARV. L. REV. 748, 749 (1929). Although both the Maine court and Berle were concerned with preferred stockholders who became such subsequent to the issuance of the common stock by promoters to themselves, the fact that in the instant case the common was issued subsequent to the dates on which the preferred stockholders became such does not seem to make the issuance any more injurious to the preferred stockholders.

80. See note 79 *supra*.

81. 360 S.W.2d at 945.

82. See Jeffs v. Utah Power & Light Co., *supra* note 79, at 470-71, 12 A.2d at 600.

83. *Cf.* BALLANTINE, CORPORATIONS 841-42 (1946). The fact that the par value of the common capital was limited to a total of $12,000 would detract from the importance of a cushion in the amount of such par value, however.

84. Regardless of the degree of injury to them, the standing of the preferred stockholders to force cancellation of the common stock issued by the directors to themselves ought to be upheld as a check on director self-dealing. Note, 54 HARV. L. REV. 139, 141 (1940).

duties" in the same sentence[85] in which it stated that there had been "no consideration"[86] for the issuance of such stock, however, may indicate that the court was concerned with a lack of common cushion and that the failure to secure assets, which would form such a cushion, in return for the common stock constituted, in the absence of the preferred's consent, a violation of the duty owed by the directors to the preferred stockholders. The court's conclusion that no consideration had been paid for the common stock issued to the directors was based on its finding that the purported payment for such stock consisted of services which had not been fully performed at the date of the stock issuance.[87]

The chancellor had based his decision cancelling the stock partly on a failure of consideration theory. He stated that since the consideration for the issuance of the common stock to the directors was past and future services in promoting the corporation, the failure of the promotion had rendered such services worthless and consequently destroyed the consideration for the shares.[88] In affirming this aspect of the chancellor's decision, the court of appeals construed[89] that decision to have held that future services were improper consideration for the issuance of stock under section 48-204 of the Tennessee Code Annotated.[90] Under either the reasoning of the chancellor or of the

85. 360 S.W.2d at 952. Part of such sentence is quoted in text at note 91 *infra*.

86. *Ibid.* The court's statement that "no consideration" existed cannot mean that all of the services rendered as payment for the common stock were valueless, since the court was willing to see one of the promoter-directors compensated (out of liquidation proceeds in excess of creditor and preferred stockholder claims) for legal services rendered in attempted payment for such stock. 360 S.W.2d at 955. As applied to legal services, the court's statement must mean that such services could not constitute consideration for purposes of § 48-204, because all of the legal services had not been rendered as of the date of the stock issuance, or, disregarding the dictum quoted in text, because all of such services had not been rendered as of the date of issuance and could not be rendered thereafter because of the failure of the promotion.

It is interesting to note that the court was willing to treat legal services differently from other promotional services. Thus, with respect to the non-legal promotional services the court seemingly adopted the view of the chancellor that such services were valueless to the corporation because the promotion had failed; but it took a different view with respect to legal services, despite the fact that these were apparently rendered as incidental to the promotion and upon the promotion's failure became worthless to the corporation. If the value of the services to the corporation in furthering its purposes is the relevant value, then it would appear that the value of both legal promotional services and other promotional services would be worthless, viewed in retrospect, after the failure of the promotion; but, viewed at the dates of rendition, *cf.* Pipelife Corp. v. Bedford, 150 A.2d 319, 321 (Del. Ch. 1959), their value would be measured by the probabilities on such dates of the success of the promotion. *Cf.* RESTATEMENT, RESTITUTION § 155, comment *d* (1937).

87. 360 S.W.2d at 953.

88. *Id.* at 947.

89. *Id.* at 952.

90. TENN. CODE ANN. § 48-204 (1956): "Shares of stock shall be issued only for money, or for other property, real or personal, tangible or intangible, or for labor or services actually received by, or conveyed or rendered to, the corporation for its use and lawful purposes, or in its possession as surplus."

court of appeals, the directors would have injured the preferred stockholders by failing to obtain a cushion of common capital in return for the issuance of the common stock.

In dictum, however, the court of appeals went somewhat further. Referring to "a breach of fiduciary duties," the court said that "it appearing that there had been no consideration for the issuance of this common stock to these directors, it could have been cancelled upon a proper procedure . . . even if the corporation had continued and succeeded actually in the completion of the purpose for which it was organized."[91] This dictum seems unnecessarily broad, since if the corporation had succeeded in the completion of the purpose for which it was organized, the promotional services would necessarily have been fully rendered, albeit subsequent to the date of issuance of the stock. Since the statutory requirement of "labor or services actually received"[92] was apparently designed to insure that a corporation receive full par value for its stock, stock issued in violation of the statutory command should be defective only while the consideration remains unpaid. If and when it is subsequently paid, the defective, nature of such stock ought to be cured.[93]

Another dictum of the court deserves some mention. The court stated that the corporation would be foreclosed from building a hospital smaller than the one described in the prospectus because "it would have been in direct violation of the description given to the public with respect to what would be built."[94] Against the defendants' argument that the powers of the corporation could not be limited by prospectus representations, the court noted that few purchasers of stock analyze the corporate charter but most such purchasers do read and rely upon statements contained in the prospectus.[95] Moreover, every contract or application of estoppel restricts the exercise of cor-

91. 360 S.W.2d at 952.

92. Note 90 *supra.*

93. See Scully v. Automobile Fin. Co., 12 Del. Ch. 174, 179, 109 Atl. 49, 51 (1920): "[F]ull paid, non-assessable shares of stock . . . can be issued only for 'labor done,' *i.e.*, after it has been done. This does not mean that shares may not be issued for services to be rendered so long as they are not marked fully paid until that condition has been fulfilled by rendering the service." See also Beard v. Elster, 160 A.2d 731, 739 (Del. 1960): "While a contract to purchase stock to be paid for in the future will not withstand contemporaneous attack in the courts, nevertheless, lapse of time and subsequent performance by the purchaser of all or part of the contemplated services will validate the purchase and will supply consideration for such portion of the contracted-for stock as is reasonably related to the value of the services performed." *But cf.* Taylor v. Citizens' Oil Co., 182 Ky. 350, 361-62, 206 S.W. 644, 649-50 (1918); Maclary v. Pleasant Hills, Inc., 35 Del. Ch. 39, 109 A.2d 830 (Ch. 1954); Section 48-206 of the Tennessee Code, which authorizes the issuance of stock which is not fully paid for, on the condition that the corporate charter provide for such issuance, does not compel a contrary conclusion.

94. 360 S.W.2d at 952.

95. *Ibid.*

porate powers. While there is a danger of destroying business flexibility in holding a business bound to every prospectus representation of planned future conduct, a departure from the instant prospectus representations which concerned the size of the proposed hospital would have basically altered the nature of the preferred stockholders' investment. While an investor in a going business can learn some objectively verifiable facts about the enterprise in which he is investing, an investor in an enterprise in the promotion stage is peculiarly dependent upon prospectus representations for information about such enterprise.

## III. Interpretation of Conditional Agreement To Reduce Salaries—Balance Sheet vs. Income Statement Approach

*Tennessee Products & Chemical Corp. v. United States*[96] was a suit for refund of federal income taxes which dealt with the interpretation of a condition attached to an obligation of a corporate officer to repay to the corporation withdrawals in excess of his salary. In 1931 the plaintiff corporation was experiencing an unprofitable period. In order to improve the financial condition of the corporation, the officers of the corporation agreed that the president should have the power to reduce their salaries on the condition that such reductions in salary would be restored to them "when business returned to where it was as good as when" the reductions were effected.[97] It was also agreed that although the salary of the chairman of the board would be reduced, the chairman nevertheless could continue to withdraw amounts equal to but not in excess of his unreduced salary and that the "overdrafts," *i.e.*, withdrawals in excess of the reduced salary, should constitute a debt owed by him to the corporation. Such debt was to be extinguished, however, on the occurrence of the above-mentioned condition, *i.e.*, "when business returned to where it was as good as when" the reduction was effected.[98]

Subsequent to the agreement reducing salaries, the corporation was reorganized under former section 77B[99] of the Bankruptcy Act. The chairman did not prove any aspect of the foregoing transaction in the reorganization proceedings; however, the debt owed by the chairman to the corporation was carried as an asset in the reorganization proceedings, apparently without cognizance having been taken of a possibility that the debt might be extinguished through operation of

96. 199 F. Supp. 885 (M.D. Tenn. 1961), *aff'd*, 297 F.2d 529 (6th Cir.), *cert. denied*, 370 U.S. 911 (1962).
97. 199 F. Supp. at 888.
98. *Ibid.*
99. 48 Stat. 911 (1934) (now Chapter X of the Bankruptcy Act, § 1, 52 Stat. 883 (1938), as amended, 11 U.S.C. §§ 501-676 (1958)).

the contingency.[100] While the corporation was still being operated under the orders of the federal court pursuant to the reorganization proceedings, the chairman died, leaving an insolvent estate. The corporation asserted in Tennessee chancery court insolvency proceedings a claim for repayment of the excess withdrawals, which was allowed in full by the chancery court.[101] In 1942 the corporation attempted to write off as a bad debt loss in its federal income tax return for that year the balance of the debt owed to it by the chairman. In a suit for refund of income taxes paid, the District Court for the Middle District of Tennessee held that the debt was not properly a bad debt loss for 1942 because prior to that time, in 1940, "good business conditions" had resumed and accordingly the debt had been extinguished by the terms of the condition attached to it.[102]

The court described the transaction between the chairman and the corporation in terms of a debt owed by the chairman to the corporation subject to extinguishment upon the occurrence of a condition subsequent.[103] It rejected the suggestion[104] advanced by counsel for the corporation that the condition subsequent should be treated as an obligation of the corporation which had to be proven by the Chairman's estate in the reorganization proceedings.[105]

In construing the phrase "good business conditions," the court attributed an income statement meaning rather than a balance sheet meaning to that phrase and equated it with the earning of some amount of current corporate income.[106] In so doing the court was

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100. 199 F. Supp. at 893.
101. *Id.* at 893-94.
102. *Id.* at 894.
103. *Id.* at 893.
104. *Ibid.*
105. Under the view of corporate counsel the condition extinguishing the debt would apparently be viewed as an obligation of the corporation which besides being proved would have to be evaluated in the reorganization proceedings. Under such a view the value of such a condition subsequent might depend upon whether the probabilities of the occurrence of good business conditions were assessed with respect to the reorganized corporation or the unreorganized corporation. Compare *In re* Ray Long & Richard R. Smith, Inc., 95 F.2d 525, 528 (2d Cir. 1938) (assuming that a claim based upon the value of corporate stock would have to be determined, if at all, with respect to stock of the unreorganized corporation) with Thompson v. England, 226 F.2d 488, 490 (9th Cir. 1955), where with respect to a loan repayment obligation contingent upon the business achieving "a sound, financial condition" the court stated that such contingency would have to be assessed with respect to a post-bankruptcy business; elsewhere in its opinion, however, the court dealt with the contingency as applicable only to the non-post-bankruptcy business. See note 112 *infra*.
106. Although the court noted that "the resumption of good business is defined in the agreement of March 16, 1931, to be when business returns to where it was as good as when each executive or individual's salary was cut," 199 F. Supp. at 888, such definition does not itself indicate whether an income statement or a balance sheet is to be used as a measure of good business conditions. Although the court did not expressly interpret the "good business conditions" phrase, it said that "there appears to be no doubt that good business conditions were resumed by the corporation in

supported by the fact that in reducing the salaries of the corporate officers, the parties' concern appeared to be with whether the corporate income would be "in black" or "in red."[107] The court was not entirely consistent in its approach, however, since it elsewhere described the contingency in terms of a balance sheet approach; thus it equated the return of "good business conditions" with the resumption of the corporation's "former condition of financial soundness."[108]

Under an income statement interpretation of the "good business conditions" phrase, the extinguishment of the chairman's debt would not take place unless it could be offset against current income;[109] extinguishing the debt when it could be so offset would not aggravate the position of corporate creditors,[110] although the debt might not remain as a corporate asset until the corporation's net asset position was restored to its amount as of the date of the salary reduc-

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1940 for the first time . . . ." *Id.* at 894. Since the court found that the corporation incurred losses for the years 1936 through 1939, and earned $254,131.45 for the year 1940, *id.* at 890, it would seem that the court equated current earnings, at least in some amount, with good business conditions.

A reading of the "good business conditions" phrase on a pure income statement basis raises some problems, however. If good business conditions mean current income in an amount not less than the amount of current income at the date of the salary reductions, accumulations of those reductions over a period of time might require extinguishment of the chairman's debt and repayment of such reductions to the other officers at a time when current income was insufficient to offset such extinguishment and repayments. Furthermore, if the discretionary power to cut salaries were exercised with respect to an officer during a period in which the corporation incurred a loss, the foregoing approach would require reimbursement of accumulated reductions at a time when the corporation had reduced its current loss to an amount not in excess of the loss incurred when the reduction went into effect, even though the corporation had never earned current income subsequent to such reduction and its financial condition was accordingly substantially worse than at the date of such reduction.

The foregoing considerations may indicate that if the parties intended an income statement reading of the good business conditions phrase, they may also have intended that the reimbursements of the salary reductions should take place only to the extent that such reimbursements could be offset against current income. Even an income statement interpretation of the contingency which would maintain the debt until its extinguishment could be offset against current income might have to be modified with some balance sheet factors in order to prevent an extinguishment of the debt in a situation in which the corporation was earning substantial current income but had liabilities in excess of its assets. *Cf.* Booth v. Booth & Bayliss Commercial School, Inc., 120 Conn. 221, 226, 180 Atl. 278, 280 (1935).

107. 199 F. Supp. at 887. See *id.* at 888. The court did not inquire in detail into the motivation of the contingent salary reductions. Some possible grounds might consist of a desire to lessen a drop in the market price of the corporation's stock, to maximize working capital, to minimize a fall in the corporation's credit position, and to assist against the incurrence of bankruptcy. The latter two grounds would carry some inference that the postponement and contingent nature of the reimbursement were designed to benefit corporate creditors.

108. 199 F. Supp. at 893.

109. See note 106 *supra.*

110. With respect to the relationship of the contingency to corporate creditors under an income statement analysis of such contingency, see note 106 *supra.*

tions.[111] Under a balance sheet approach, however, the debt would in effect remain an asset for the benefit of corporate creditors during the interval in which the net assets of the corporation had shrunk below their amount on the date of the salary reductions.[112]

The court viewed the occurrence of the reorganization to be irrelevant to the interpretation of the "good business conditions" contingency, which would extinguish the chairman's debt, even though it conceded that the occurrence of good business conditions may have been possible only because of the reorganization.[113] Even on an income statement interpretation of the contingency, the parties may have intended to maintain the debt for the benefit of creditors until it could be extinguished without aggravation of the creditors' position.[114] If the reorganization was an insolvency reorganization—which the opinion indicates that it was[115]—the subsequent extinguishment of the debt might have conflicted with such intention, since

111. See note 106 *supra.*

112. A balance sheet approach would be tantamount to subordinating the chairman's claim to reimbursement to the claims of the corporation's other creditors. In the case of the other officers whose claims for reimbursement were in the form of claims for cash rather than in the form of a condition subsequent extinguishing an indebtedness, the subordination of the reimbursement claim would perhaps most clearly appear. *Cf.* Thompson v. England, 226 F.2d 488, 491 (9th Cir. 1955), in which the court reached the subordination result with respect to a loan repayment obligation conditioned on the debtor's business achieving "a sound, financial condition" when the court stated that it was dealing with "a contract in which the condition precedent to liability . . . the bankruptcy makes certain never to arise." *Cf. In re* Philip A. Singer & Brother, Inc., 114 F.2d 813, 814 (3d Cir. 1940): "the salaries of the debtor's employees were cut in half with a moral obligation upon the debtor's part to restore such cuts if the future state of the business warranted it. The debtor's business got worse instead of better; the debtor sought relief in a court of bankruptcy; and the moral obligation ceased to exist." *But cf.* Royal Tiger Mines Co. v. Ahearn, 97 Colo. 116, 47 P.2d 692, 696 (1935), holding with respect to a business whose obligation to repay a debt was contingent upon such payment being "convenient" that unfavorable prospects for future profitable operation would mature the repayment obligation and permit the creditor to whom such contingent obligation was owed to share in the assets of the debtor proportionately with other creditors; since the debtor was stipulated to have possessed assets in excess of liabilities, however, the subordination issue was not presented.

Under the above analysis, similar treatment of the chairman's claim for reimbursement of salary reductions would result whether the obligations of the corporation to the chairman and of the chairman to the corporation were deemed to be separate as suggested by corporate counsel or "inextricably interwoven," as determined by the court, 199 F. Supp. at 893. Under the separate obligation view, the claim of the chairman to reimbursement would be evaluated at the time of the reorganization proceedings, and if the contingency were read in balance sheet terms, the court should probably construe the contingency as in effect making the chairman's claim subordinate to the claims of other creditors. Under the "inextricably interwoven" reading of the obligations adopted by the court a balance sheet reading of the contingency would preserve the chairman's debt for the benefit of corporate creditors at least during a period of insolvency.

113. 199 F. Supp. at 894.

114. See note 106 *supra.*

115. 199 F. Supp. at 893.

at the time at which the creditors were paid in the reorganization proceedings a debt owed to the corporation by a solvent debtor could neither have been eliminated nor reduced in amount without aggravating the creditors' position. Since the possibility of subsequent extinguishment would reduce the value of such a debt as of the date of the reorganization proceedings, such possibility might accordingly have been foreclosed by an insolvency reorganization. Although the insolvency of the Chairman's estate occurred prior to the completion of the reorganization proceedings and substantially reduced the value of the chairman's debt, the occurrence of a reorganization in which creditors were not fully compensated ought to have had the effect of eliminating the possibility of subsequent extinguishment of that debt in order that whatever value remained in such debt might serve to compensate such creditors. On a balance sheet interpretation of the contingency, under which the chairman's debt would remain as an asset for the benefit of creditors, an insolvency reorganization would seem to foreclose the possibility of a subsequent extinguishment of such debt for similar reasons.