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BUSINESS ASSOCIATIONS—1959 TENNESSEE SURVEY

F. HODGE O'NEAL*

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The Eighty-first General Assembly enacted a considerable number of significant statutes affecting business organizations or their activities. One of the new statutes made important changes in the Securities Law of 1955. Several of the statutes were designed, or at least professed to be designed, to encourage the commercial and industrial development of Tennessee. On the other hand, Tennessee courts handed down during the survey period only two or three opinions touching on business associations questions, and those questions were of but little importance. In general, this article discusses the statutes first, then the judicial decisions.

I. AMENDMENTS TO THE SECURITIES LAW

The Securities Law of 1955[1] requires the registration of securities offered for sale in the state of Tennessee and the registration of dealers and salesmen of securities. The administration of the law is vested in the Commissioner of Insurance and Banking.

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1. TENN. CODE ANN. §§ 48-1601 to -1648 (Supp. 1958).

Chapter 228 of the 1959 acts[2] made a number of changes in the Securities Law. It provides that the Commissioner as authorized by the Governor shall appoint a Director for the securities division, and that the Commissioner may with the consent of the Governor employ an assistant director for the division.[3] The new statute also increases the amount of information which must be filed with the Commissioner by an applicant registering securities for sale.[4] In addition to the information which an applicant for registration has had to provide in the past, he must now file the following items: (1) names of states other than Tennessee in which a filing has been made or will be made and names of states, if any, in which filing has been denied or voluntarily withdrawn, and (2) whatever information the Commissioner may require relative to promotional interests, stock ownership and the escrow of the proceeds of securities sales.

The new statute requires the use in securities sales of a printed prospectus containing information on the issuer of the securities and its financial condition.[5] The use of this prospectus, however, may be waived by the Commissioner. The statute also gives the Commissioner authority to require a company, if it is a new company or a company in poor financial condition proposing to sell securities to raise working capital, to escrow an amount necessary to successfully finance the new enterprise or to provide adequate working capital for the company in poor financial condition.[6]

The Securities Law of 1955 provides that certain securities shall be exempt from its registration requirements.[7] Until the enactment of chapter 228 of the 1959 acts, the exemption included the securities of insurance companies subject to the supervision of an agency of the state of Tennessee and domiciled in Tennessee or in operation for at least five years. Chapter 228 removed the exemption from the securities of such insurance companies.[8]

Chapter 228 increased the Commissioner's power to regulate dealers and salesmen of securities.[9] Under the new legislation the Commissioner may require applicants for registration as securities salesmen to take written examinations to determine their training and their knowledge and understanding of the Tennessee Securities Law. The new legislation also sets forth additional grounds on which the Commissioner may suspend or revoke a dealer's or a salesman's registration.

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2. Tenn. Pub. Acts 1959, ch. 228.
3. Tenn. Pub. Acts. 1959, ch. 228, § 2.
4. Tenn. Pub. Acts 1959, ch. 228, § 3.
5. *Ibid.*
6. *Ibid.*
7. TENN. CODE ANN. § 48-1619 (Supp. 1958).
8. Tenn. Pub. Acts 1959, ch. 228, § 4.
9. Tenn. Pub. Acts 1959, ch. 228, §§ 5-6.

Until the 1959 amendments the Securities Law provided that any person who shall *willfully* violate a provision of the law shall be guilty of a criminal offense.[10] Chapter 228 eliminates the word "willfully"[11] and thus apparently imposes criminal liability on a person who violates a provision of the law irrespective of whether the violation was intentional.

Chapter 228 further provides that no advertising offering a registered security for sale shall be published, circulated, distributed or broadcast until it has been approved by the Commissioner, and the Commissioner is given the power to disapprove any advertising which he considers to be in conflict with the provisions and purposes of the act.[12] The new statute also sets up strict regulations[13] governing the sale of promotional[14] and speculative securities.[15] For example, speculative securities subscribed to by the issuer, promoters and organizers must be placed in escrow, and a prospectus for promotional and speculative securities must have set forth on its outside front page the following statement in capital letters printed in boldface roman type at least as large as ten-point modern type and at least two-point lead: "These are speculative securities." Finally, the Commissioner is given power to conduct examinations of the operations of investment companies and security dealers doing business in Tennessee.[16]

II. Small Business Investment Companies

By the Small Business Investment Act of 1958,[17] Congress provided for the establishment of small business investment companies, *i.e.*,

10. Tenn. Code Ann. § 48-1648 (Supp. 1958).
11. Tenn. Pub. Acts 1959, ch. 228, § 7.
12. Tenn. Pub. Acts 1959, ch. 228, § 8.
13. Tenn. Pub. Acts 1959, ch. 228, § 9.
14. "Promotional securities" are defined as "securities issued for services rendered, patents, copyrights or other intangibles, the value of which has not been established to the satisfaction of the commissioner, or which are issued for a monetary consideration substantially lower than the consideration for which shares are sold for primary financing purposes." Tenn. Pub. Acts 1959, ch. 228, § 1.
15. "Speculative securities" are defined as "(1) all securities to promote or induce a sale of which, profit, gain or advantage, unusual in the ordinary course of legitimate business, is in any way advertised or promised, or (2) all securities the value of which materially depends on proposed or promised future promotion, or development rather than upon present tangible assets or conditions, or (3) all securities of any enterprise, association, partnership or corporation, which has included or proposes to include in its assets as a material part thereof patents, formulas, goodwill, promotional or any intangible assets, or which has issued or proposes to issue a material part of the securities in payment for formulas, patents, goodwill, promotional or intangible assets, or (4) any undivided interests or certificates of participation based on any undivided (sic) interest in oil or mineral leases, where the value of such undivided interest or certificate of participation materially depends on proposed or promised future development." Tenn. Pub. Acts 1959, ch. 228, § 1.
16. Tenn. Pub. Acts 1959, ch. 228, § 10.
17. 72 Stat. 689 (1958), 15 U.S.C.A. §§ 661-696 (Supp. 1958).

companies whose purpose is to supply equity capital and long-term credit for small businesses. Although the organization of small business investment companies is encouraged by the federal government, such companies are not government agencies. They are privately owned; they are organized to make a profit; they, not the government, select the businesses to which they will lend money or in which they will invest.

As a general proposition, small business investment companies are incorporated under state law, but the Small Business Administration may grant federal charters if state-chartered corporations cannot operate in accordance with the purposes of the Small Business Investment Act. Before a small business investment company can begin operations it must not only comply with the incorporation procedures set up by state law but it must also obtain a license to operate from the Small Business Administration. Under the act, SBA cannot issue a license to a company unless it has a paid-in capital and surplus of at least $300,000; but SBA itself can purchase up to $150,000 of a company's debentures to provide half of the initial minimum fund. Rules and regulations governing the organization and operation of small business investment companies can be obtained from the Office of Information, Small Business Administration, Washington, D. C.

To implement the Small Business Investment Company Act in Tennessee and to encourage the establishment of small business investment companies here, the Tennessee General Assembly enacted chapter 22 of the 1959 acts.[18] That statute provides first that small business investment companies chartered by Tennessee's Secretary of State under the provisions of the Tennessee Code dealing with private corporations[19] are authorized to perform the functions prescribed by the Small Business Investment Act, and that as long as a small business investment company is licensed, supervised and inspected by the Small Business Administration, it shall not be subject to supervision by agencies of the State of Tennessee, other than the Tennessee Department of Insurance and Banking pursuant to the Tennessee Securities Law of 1955.[20] The statute also authorizes state banks to purchase stock in small business investment companies. Finally, it provides that negotiable obligations of small business investment companies and negotiable obligations endorsed by such companies with recourse, when properly secured, shall be eligible for purchase by insurance companies, investment companies, industrial development corporations, trustees administering employee or profit-sharing

18. Tenn. Pub. Acts 1959, ch. 22.
19. TENN. CODE ANN. §§ 48-101 to -713 (Supp. 1958).
20. TENN. CODE ANN. §§ 48-1601 to -1648 (Supp. 1958).

trusts, trustees of eleemosynary institutions, and other trustees and fiduciaries.

III. Development Credit Corporations

Chapter 170 of the 1959 acts[21] is a fourteen-page statute which authorizes the organization in Tennessee of development credit corporations and states rules governing their organization and operation. The act provides that twenty-five or more persons, a majority of whom must be residents of Tennessee, may form a development credit corporation for the purpose of advancing the prosperity and economic welfare of the state.[22] Among other things the purposes of a development credit corporation may be "to stimulate and assist in the expansion of all kinds of business activity which would tend to promote the business development and maintain the economic stability of the state" and "to furnish money and credit to approved and deserving applicants for the promotion and development and conduct of all kinds of business activity in the state, thereby establishing a source of credit not otherwise readily available therefor."

In general, the rules governing the organization and operation of development credit corporations are the same as those governing private corporations. There are, however, a number of important differences. For instance, in a development credit corporation all stock must be common with a par value of $10 per share, the minimum capital stock to be 100,000 shares, and at least 20 per cent of the capital stock must be paid into the corporation's treasury before it may transact business.[23] And the certificate of incorporation of a development credit corporation must be approved by the Commissioner of Insurance and Banking, while such approval of course is not required in the organization of an ordinary private corporation.

An interesting difference between a development credit corporation and a private corporation is that the former may have members as well as stockholders. The new act provides that any financial institution may request membership in the corporation by applying to the corporation's board of directors. If the application is accepted, the financial institution thereafter, subject to limitations contained in the act, makes loans to the corporation as and when called upon to do so on terms and other conditions approved by the corporation's board of directors. Membership in a corporation is for the corporation's duration, except that a member may withdraw on giving three years' notice.

Both stockholders and members of a development credit corporation participate in the election of directors, the adoption and modifi-

21. Tenn. Pub. Acts 1959, ch. 170.
22. Tenn. Pub. Acts 1959, ch. 170, § 3.
23. *Ibid.*

cation of by-laws, charter amendments and the exercise of such other powers as are conferred on stockholders and members by the by-laws. Each stockholder has one vote for each share of capital stock held by him and each member has one vote plus an additional vote for each $1,000 in excess of the first $1,000 which the member is authorized to have outstanding on loans to the corporation. The business and affairs of the corporation must be managed and conducted by a board of directors, a president and treasurer and such other officers and agents as the corporation, by its by-laws, shall authorize. The members of the corporation elect two-thirds of the board and the stockholders elect the remainder.

An unusual provision in the statute is one stating that directors and officers of development credit corporations shall be held responsible only for losses occurring through their *willful* misconduct.

Development credit corporations are subject to supervision by the Commisioner of Insurance and Banking and must from time to time make reports to that official.[24]

IV. SPECIAL PRIVILEGES OF FOREIGN CORPORATIONS AND OTHER ORGANIZATIONS INVESTING IN LOANS ON REAL ESTATE

Before its amendment in the Eighty-first General Assembly, section 45-1201 of the Tennessee Code[25] provided that a foreign mutual savings bank, a foreign mutual savings fund society, or a foreign corporation all the stock of which was owned by an organization of one of those types, should not be considered to be transacting or engaging in business in Tennessee because it acquired loans secured by mortgages or deed of trust on property situated in Tennessee or because it engaged in specified activities (enumerated in the statute) connected with handling the loans. Section 45-1202[26] in turn provided that the organizations referred to in section 45-1201, as long as their activities were restricted to investment in loans on real estate and acts connected therewith, need not qualify to do business in Tennessee or pay foreign corporation privilege taxes, excise taxes, franchise taxes, or annual corporation filing fees. Chapter 28 of the 1959 acts[27] adds to the list of foreign financial institutions which will not be considered as doing business in Tennessee when they invest in real estate loans and which will be exempted from the named taxes, the following: national banking associations, banks, trust companies, foreign insurance com-

24. See also Tenn. Pub. Acts 1959, ch. 222 (amending Tennessee Code sections relating to industrial development corporations); Tenn. Pub. Acts 1959, ch. 243 (authorizing counties and incorporated cities and towns to purchase under stated circumstances stock in development credit corporations).
25. TENN. CODE ANN. § 45-1201 (Supp. 1958).
26. TENN. CODE ANN. § 48-1202 (Supp. 1958).
27. Tenn Pub. Acts 1959, ch. 28.

panies, and foreign corporations all of whose stock is owned by one or more organizations of the enumerated kinds. Chapter 28 also adds to the list of privileged activities which may be taken in connection with the handling or holding of the loans, without the necessity of qualifying and without incurring tax liability. The preamble of chapter 28 states that the act "will promote home ownership and provide out-of-state capital for the industrial and commercial development of this state." But query whether the granting of these special privileges to foreign financial institutions is to the best interests of Tennessee and its people.

V. General Welfare Corporations

The Tennessee Code, title 48, chapter 11[28] provides for the organization and operation of general welfare corporations, *i.e.*, corporations organized "for the general welfare of society" and not for individual profit. Two sections of that chapter of the code were amended by laws enacted by the Eighty-first General Assembly.

One of the amended provisions was section 48-1101, which enumerates in a wordy and overlapping fashion the religious, charitable, educational and welfare activities which are permissible objects for general welfare corporations. Chapter 157 of the 1959 acts[29] adds to the list of approved organizations the following: "Organizations or other associations organized for the promotion of literature, education, science or art, or any other association organized for the promotion of bodily or mental health, and all other organizations organized to promote either or all of the above named objects."

The Eighty-first General Assembly also amended section 48-1106 of the Tennessee Code.[30] Before amendment the section read as follows: "Any corporation chartered under the laws of Tennessee for religious, charitable, educational, missionary, or other eleemosynary purposes, and not for profit, shall have the power to receive property, real, personal or mixed, by purchase, gift, devise, or bequest, sell the same and apply the proceeds toward the promotion of the objects for which it is created, or hold any such property and apply the income and profits towards such objects." Chapter 23 of the 1959 acts[31] deletes the word "or" before "other eleemosynary purposes" and adds after those words the phrase "or any other purposes." The effect of the amendment is to make clear that the power to receive and use property is not limited to corporations chartered for the purposes

28. Tenn. Code Ann. §§ 48-1101 to -1121 (1956).
29. Tenn. Pub. Acts 1959, ch. 157.
30. Tenn. Code Ann. § 48-1106 (1956).
31. Tenn. Pub. Acts 1959, ch. 23.

specifically mentioned in the section but is held by all nonprofit corporations.

One decision of the Tennessee Court of Appeals, Middle Section, *Hamilton* v. *Gleaves*,[32] dealt with a general welfare corporation. In that case, Post 5 of the American Legion of Nashville, desiring to build a race track, organized a general welfare corporation called "American Legion Amusements, Inc." That corporation employed complainant to make surveys and design the track. Thereafter the corporation entered into a contract with Builders to construct the track, agreeing to pay Builders ten per cent of gate receipts and to put an additional ten per cent of the receipts in escrow as security to assure Builders' recovery of construction costs. The corporation was not successful in operating the track, and a general creditors' bill was filed against it. At that point, in an effort to help American Legion, Builders entered into a contract with the corporation under which Builders agreed to release to it the funds in escrow ($14,000) in consideration of the corporation's promise (1) to pay all of the corporation's debts except those due Builders, and (2) to transfer to a new company to be formed by Builders, the lease on the race track premises and the small amount of miscellaneous personal property the corporation owned. Complainant contended that (1) this transaction was a fraudulent conveyance, and (2) the lease the corporation held on the track and the personal property it held constituted a trust fund for all of its creditors, which trust fund had been diverted by this transaction. The court of appeals sustained the chancellor's findings that Builders gave a valuable consideration for the transfer of the corporation's property and that the transfer was made without intent to hinder or defraud complainant or any other creditor. In response to complainant's contention that the trust fund doctrine applied and that the corporation's assets were subject to a trust for the benefit of him and other corporate creditors, the court quoted langnage from various authorities to the following effect: the trust fund doctrine means only that the property must first be appropriated to the payment of company debts before any part of it can be distributed to stockholders; it does not mean that corporate property cannot be sold or mortgaged to a bona fide purchaser for a valuable consideration; a purchaser may deal with a corporation in the same manner as with an individual seller, and with no greater danger of being held to have received property burdened with a trust or lien.[33]

VI. Actions Against Unincorporated Associations

Section 20-223 of the Tennessee Code[34] provides in part that any

32. 316 S.W.2d 335 (Tenn. App. M.S. 1958).
33. 316 S.W.2d at 341-42.
34. Tenn. Code Ann. § 20-223 (1956).

unincorporated association or organization, whether resident or nonresident, doing or desiring to do business in this state shall appoint an agent here upon whom process may be served, and shall certify the agent's name and address to the clerk of the circuit court of each county in which the association or organization is to perform acts. If the agent is not appointed, process may be served on the Secretary of State of Tennessee. Chapter 110 of the 1959 acts[35] amends that code section to make clear that nonresident partnerships, just as other unincorporated associations and organizations, are covered by the section and must appoint resident agents for the service of process.

VII. Tax on Foreign Corporations with Earnings, Property, or Business in Tennessee

Chapter 252 of the 1959 acts[36] imposes on foreign corporations, corporations conducting business for profit, joint stock companies, and business trusts, if they have net earnings in Tennessee or own property or engage in business activities in Tennessee, taxes equivalent to those imposed on Tennessee corporations as franchise taxes and as excise taxes on corporate earnings.[37] The new statute states that this tax on foreign business organizations is not to be construed as a tax on the privilege of carrying on business in Tennessee but is to be considered a tax "upon the privilege of being in receipt of or realizing net earnings in Tennessee."[38]

VIII. Number of Incorporators for Religious Corporations

The Tennessee Code, title 48, chapter 13[39] provided that a charter could be granted to not less than five nor more than fifteen persons to transact the business affairs of a religious organization. Chapter 206 of the 1959 acts[40] increased the permissible maximum number of incorporators to twenty-five.

IX. Charters of Corporations for the Higher Education of Teachers

Chapter 52 of the Acts of 1909,[41] governing the creation and organization of corporations for the higher education of teachers, provided that the charters of such corporations should contain, in the enumeration of general powers, the following langnage: "provided, however, that no mortgage of any real estate of the corporation shall be valid if inconsistent with the trusts on which it is held, and unless author-

35. Tenn. Pub. Acts 1959, ch. 110.
36. Tenn. Pub. Acts 1959, ch. 252.
37. See Tenn. Code Ann. §§ 67-2701 to -2724, 67-2901 to -2931 (Supp. 1959).
38. Tenn. Pub. Acts 1959, ch. 252, § 1.
39. Tenn. Code Ann. §§ 48-1301 to -1311 (1956).
40. Tenn. Pub. Acts 1959, ch. 206.
41. Tenn. Pub. Acts 1909, ch. 52.

ized by the votes of two-thirds of the entire Board of Trustees and on order of the Court of Chancery." The Code of Tennessee of 1932 omitted the statutory provision requiring this charter proviso and no corresponding requirement was included in chapter 142, Acts of 1875,[42] governing the creation and organization of general welfare corporations, including colleges and universities, or in the sections of the present Tennessee Code applicable to general welfare corporations. In order to bring the charters of educational corporations formed under the 1909 law into conformity with those formed under later legislation, the General Assembly by chapter 184 of the 1959 acts[43] amended charters of corporations for the higher education of teachers organized under the 1909 legislation eliminating the following language: "and unless authorized by the votes of two-thirds of the entire Board of Trustees and on order of the Court of Chancery."

X. LICENSING OF MONEY LENDERS

Chapter 315 of the 1959 acts[44] provides that hereafter money lenders must obtain a license from the Commissioner of Insurance and Banking. Heretofore money lenders were required to obtain a certificate from the Superintendent of Banks and a license from the county court clerk.[45]

XI. BEQUEST OF STOCK IN CORPORATION WHICH DID NOT COME INTO EXISTENCE UNTIL AFTER WILL'S EXECUTION

The Tennessee Code provides that a will "shall be construed, in reference to the real and personal estate comprised in it, to speak and take effect as if it had been executed immediately before the death of the testator."[46] Applying this provision, the Supreme Court of Tennessee in *Sadow* v. *Solomon*,[47] held that a will bequeathing to the testator's son all stock in a specified corporation (designated by name) owned by testator at death, passed the stock to the son even though the corporation did not come into existence until after the execution of the will. The will bequeathed stock in "Independent Theatres, Inc." A corporation with that name had been dissolved about five years before the execution of the will, and at the time of the will's execution the testator owned stock in "Independent Theatres, Incorporated" and served that corporation in a managerial capacity. About two months after the execution of the will, another

42. Tenn. Pub. Acts 1875, ch. 142.
43. Tenn. Pub. Acts 1959, ch. 184.
44. Tenn. Pub. Acts 1959, ch. 315.
45. See TENN. CODE ANN. §§ 45-2101 to -2123 (1956). For other 1959 legislation dealing with lenders, see Tenn. Pub. Acts 1959, ch. 205 (endorsement companies).
46. TENN. CODE ANN. § 32-301 (1956).
47. 319 S.W.2d 83 (Tenn. 1958).

corporation named "Independent Theatres, Inc." was organized. The court held that the bequest passed stock in the latter corporation, finding no ambiguity in the language of the bequest which was to the effect that the stock bequeathed is stock owned at the death of the testator in Independent Theatres, Inc., *being* a Tennessee corporation.

XII. Whether Partnership Real Property Descends as Personalty

Brown v. *Brown*,[48] decided by the Court of Appeals of Tennessee, Middle Section, raised the question of whether real estate deeded to and standing on the name of the partnership, passed as personalty or as realty on the death of the partners. In that case the deed stated that the conveyance was to "Brown Bros., a partnership,—to have and to hold said land unto the said Brown Bros., a partnership, their successors and assigus for ever." And, in addition, the deed contained a covenant to the following effect: "that I will warrant and defend the title to said land unto said Firm of Brown Bros., its successors and assigns against the lawful claims of all persons whomsoever." The court held that the deed not only raised a presumption of ownership by the partnership but affirmatively showed title in the partnership. The court further held that partnership property purchased with partnership funds need not be actively used in the firm to remain a firm asset. "It seems clear that a partnership, even though it be primarily a mercantile concern, could purchase real estate for investment purposes, in the partnership name, and hold said property as an asset of the partnership for the purpose of reaping the benefit of increased value or for any other reason that might appeal to the partners."[49] The final point decided by the court was that under the Uniform Partnership Act[50] when a partnership acquires realty in the partnership name with partnership funds it then becomes personalty for all purposes including distribution and that the realty passes as personalty on the death of the partners even though the realty was not actively used in the partnership business.[51]

48. 320 S.W.2d 721 (Tenn. App. M.S. 1958).
49. 320 S.W.2d at 729.
50. Tenn. Code Ann. §§ 61-101 to -142 (1956).
51. For a Tennessee case discussing the nature of the obligations of partners under Louisiana law, see Spencer Kellogg & Sons, Inc. v. Lobban, 315 S.W.2d 514 (Tenn. 1958) (suit against Tennessee resident on obligation of Louisiana firm of which he was a member properly dismissed on basis of law of partnership's domicile).