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Corporations and Securities Regulation

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I. Corporations
A. Recent Legislation

1. Close Corporation Act

For a number of years attorneys have recognized the fact that closely held corporations simply cannot operate effectively within the framework of general corporation statutes, which, for the most part, were tailored to fit the publicly-held corporation. Accordingly, resort has been made to such devices as pre-incorporation agreements, special charter and by-law provisions, share transfer restrictions, shareholders’ agreements, voting trusts, irrevocable proxies, and long-term employment contracts—all with the central purpose of keeping the close corporation close.¹ With few exceptions, however, legislatures and courts have failed to recognize the differences between publicly-held and close corporations. Therefore, the Florida Legislature is to be complimented for its adoption of a separate statute² tailored to the special characteristics of the close corporation. The newly adopted statute is not comprehensive. It does not meet all of the needs of the close corporation. But it is a welcome step in the right direction.

The statute’s application is permissive and not mandatory.³ It defines a “close corporation” as a “corporation for profit whose shares of stock are not generally traded in the markets maintained by securities dealers or brokers.”⁴

A few years ago a North Carolina case⁵ attracted national attention

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3. The act “shall have no application to any close corporation in existence on September 1, 1963, unless such previously existing close corporation shall elect to bring itself within the provisions of this act by written consent of the owners of a majority of the voting stock.” Fla. Stat. § 608.0100(1) (1963).
5. Park Terrace, Inc. v. Phoenix Indem. Co., 241 N.C. 473, 85 S.E.2d 677 (1955), re-
by reason of its square holding that in order for a corporation to have legal existence there must be a minimum of three shareholders at all times. In that case the Supreme Court of North Carolina concluded that when less than three persons acquired all the shares, the corporation became "dormant" and no longer acted as a corporation. Among other things, this holding enabled creditors and other plaintiffs to disregard the corporate entity and hold shareholders individually liable in all one-man and two-man corporate situations. The new Florida Close Corporation Act expressly negatives this possibility by providing as follows:

The existence of a corporation, hereafter or heretofore formed under the laws of this State, shall in no respect be deemed impaired by the acquisition of all the shares of stock of such corporation by one person or by two persons, nor shall the corporation, by such acquisition, be deemed not to possess any managerial boards or bodies or any capacities, powers or authority which it would have possessed with three or more stockholders, nor shall the corporation, upon such acquisition, be deemed to have become dormant, inactive or incapable of acting as a corporation. 8

The new statute contains numerous other ameliorating features of assistance in solving the special problems of the close corporation. It provides, for example, that the articles of incorporation may provide for the corporation to be managed by the stockholders rather than by a board of directors. It permits the stockholders to take action by written consent without a meeting. It permits stockholders' agreements governing management and other matters.

But perhaps its most significant provision allows the stockholders "at any time [to] remove [directors], with or without cause. . . ." 9 This new provision reflects the seriousness of a problem that existed prior to its enactment—one that was brought into sharp focus in the Florida case of Frank v. Anthony. 8 P, the president of a corporation, became its sole shareholder and director upon its organization and the resignation of two "dummy" incorporators and directors. As the remaining director, P designated A and B to fill the vacancies created on the board. 9 The directors then adopted a resolution authorizing only A and B to draw checks on the corporate bank account. Later, at a special but informal meeting of the board, P was removed as president by a 2-1 vote. That same day P called a special stockholders' meeting, and, as sole stock-

8. 243 N.C. 595, 91 S.E.2d 584 (1956). The North Carolina code was subsequently amended to provide that limited liability is not lost "even if all the shares are owned by one person." N.C. GEN. STAT. §§ 55-53(c) (1963).
8. 107 So.2d 136 (Fla. 2d Dist. 1958).
9. This procedure is required by FLA. STAT. § 608.08(2) (1963).
holder, elected himself and two other persons as directors. At this time there was no charter or by-law provision for the removal of directors, but P voted to amend the by-laws to authorize removal without cause. The "new board" then authorized only P to draw checks on the corporate bank account. P then sought a declaratory decree declaring him to be the president, and an injunction restraining A and B from acting as directors and requiring the bank to honor only P's signature on the corporation's checking account. The relief sought was denied. The decision serves as a warning of the dangers to majority shareholders in close corporations. In practical effect, even lock, stock and barrel ownership may not equal control. The provision in the new act permitting removal of directors by the stockholders with or without cause avoids many pitfalls.

B. Other Corporate Legislation

1. MERGER AND CONSOLIDATION

The corporate code was amended to allow a Florida corporation to merge or consolidate with corporations organized under any other "territory, possession or jurisdiction of the United States..." Prior to this amendment only the word "state" had appeared in the section, thus making unclear the power to merge with other than corporations organized under the laws of one of the 50 states.

2. STOCKHOLDER'S DERIVATIVE ACTIONS

A new section was added to the code authorizing corporations to reimburse directors or officers for expenses sustained in defense of a stockholder's derivative action "except in relation to matters as to which such director or officer was adjudged to have been guilty of negligence or misconduct in the performance of his duty to the corporation." Prior to the adoption of this amendment, there was a common-law conflict as to whether corporate directors and officers were entitled to indemnification or reimbursement for their reasonable expenses incurred in defending a shareholder's derivative suit for alleged breach of official duty, in which they were vindicated of charges of wrongdoing.

A corollary section now provides that a successful plaintiff in a shareholder's derivative action may be awarded "the reasonable expenses

10. The suggestion might be advanced that P, at the special meeting of shareholders, could have amended the bylaws to increase the number of directors and thus regained the balance of voting power by "loading" the board. But even this avenue was not open to him, for the corporate code provides: "Vacancies shall be filled by the directors remaining in office... An increase in the number of directors shall create vacancies for the purpose of this section..." FLA. STAT. § 608.08(2) (1963).
of maintaining the action, including reasonable attorney's fees. . . .\textsuperscript{18}

Inasmuch as the derivative suit is actually a mandatory class action for the benefit of the corporation and other shareholders, the successful plaintiff who carries the burden of the expense of litigation is certainly entitled to such an award. But that is not the whole story. Another new section requires plaintiffs in shareholder's derivative actions to give security for the estimated expenses of the defendants, unless the plaintiff holds five per cent or more of the outstanding shares, or unless his shares have a market value in excess of $50,000.\textsuperscript{14} This section is controversial. Inspired by a similar statutory provision enacted by the New York legislature,\textsuperscript{15} its obvious purpose is to discourage "strike" or nuisance actions. The provision has been vigorously attacked, however, on the ground that it denies to the small investor any civil remedy for breach of fiduciary duties on the part of those persons entrusted with the management and direction of the corporation.\textsuperscript{16}

An additional change involves codification of the "contemporaneous ownership" rule as a condition precedent to the bringing of a shareholder's derivative action. In short, the plaintiff must be a stockholder "at the time of bringing the action" and must show that he had been a stockholder "at the time of the transaction of which he complains, or that his interest devolved upon him by operation of law."\textsuperscript{17} Prior to this amendment, the Florida common law had followed this view,\textsuperscript{18} although a conflict still exists in other jurisdictions.

Finally, the new amendments, in accord with common-law principles on shareholder's derivative actions, provide that the complaint "must set forth with particularity the efforts of the plaintiff to secure the initiation of such action by the board of directors of such corporation or the reasons for not having made such effort. . .\textsuperscript{19} and that no shareholder's derivative action may be "discontinued, compromised or settled without the approval of the court having jurisdiction of the action."\textsuperscript{20} In view of a legion of common-law decisions in line with

\begin{itemize}
\item \textsuperscript{13} FLA. STAT. § 608.131(5) (1963).
\item \textsuperscript{14} FLA. STAT. § 608.131(4) (1963). The amount of the security may be increased or reduced from time to time in the discretion of the court "upon showing that the security provided has or may become inadequate or excessive." \textit{Ibid}.
\item \textsuperscript{15} N.Y. GEN. CORP. LAW § 64 (1950).
\item \textsuperscript{16} Hornstein, \textit{The Death Knell of Stockholders' Derivative Suits in New York}, 32 CALIF. L. REV. 123 (1944).
\item \textsuperscript{17} FLA. STAT. § 608.131(1) (1963).
\item \textsuperscript{18} News-Journal Corp. v. Gore, 147 Fla. 217, 2 So.2d 741 (1941).
\item \textsuperscript{19} FLA. STAT. § 608.131(2) (1963). See Orlando Orange Groves Co. v. Hale Co., 107 Fla. 304, 144 So. 674 (1932), where it was held that a request by the shareholder was not necessary to the maintenance of the action when such a request "would not have served any useful purpose."
\item \textsuperscript{20} FLA. STAT. § 608.131(3) (1963). See Young v. Higbee Co., 324 U.S. 204 (1945), which expressed the principle now codified in \textit{FLA. STAT.} § 608.131(3) (1963).\end{itemize}
these last points, one may not reasonably quarrel with the new legislation.

Other changes adopted at the 1963 session of the Florida legislature include: (1) a provision that a corporation shall file with the secretary of state a written acceptance of the appointment of its resident agent; 21 (2) a provision for increase in the schedule of fees for the capital stock tax; 22 (3) a provision permitting the secretary of state to destroy charters of dissolved corporations after photographing such charters, and permitting such photographs to be admissible as evidence as if they were the original charters; 23 (4) a provision that upon voluntary dissolution of a corporation, an affidavit must be filed with the secretary of state that all taxes have been paid by the corporation; 24 (5) a provision specifying the effective dates of corporate existence, amendments to the articles of incorporation, and voluntary dissolution when not otherwise specified; 25 (6) a provision prescribing procedure for reincorporation of non-profit corporations whose charters were approved by a circuit judge or granted by the legislature prior to September 1, 1959. 26

C. Recent Cases

1. SEPARATE ENTITY PRIVILEGE

With a fair degree of consistency courts have adhered to the doctrine that the separate corporate entity privilege will not be disregarded unless that privilege has been abused. The fact that the corporation is organized for the avowed purpose of escaping personal liability does not of itself spell abuse of the privilege. Thus, in a recent Florida case 27 it was held that the Florida Industrial Commission had no jurisdiction to disregard legal entities and hold another corporation and partnership jointly liable with a corporate employer for payment of compensation benefits on the theory that the partnership and corporations were in fact one and not three separate legal entities. In discussing the nature of the corporate entity, the court had this to say:

Those who utilize the laws of this state in order to do business in the corporate form have every right to rely on the rules of law which protect them against personal liability unless it be shown that the corporation is formed or used for some illegal, fraudulent or other unjust purpose which justifies piercing the corporate veil. This is the reason for the rule

stated in all Florida cases, that the courts are reluctant to pierce the corporate veil and will do so only in a court of competent jurisdiction, after notice to and full opportunity to be heard by all parties, and upon showing of cause which necessitates the corporate entity being disregarded in order to prevent some injustice.  

Although a Florida statute prohibits the charging of usurious rates of interest, the statute expressly excludes loans to corporate borrowers. It has been held that the usury laws may not be frustrated by the use of a corporate shell to cloak a loan actually made to an individual borrower. In that case, however, there was a preponderance of evidence to the effect that the corporation had been formed at the insistence of the lenders as a prerequisite to their making of the loan and as a sham contrivance to defeat the usury statutes applicable only to loans to individuals. In a more recent case, where the corporate borrower had been in existence for three years and had owned mortgaged property for six months prior to applying for the loan on the property, the court found that the loan was made to the corporation and rejected the argument that the corporate entity privilege had been abused. 

When officers or agents of a corporation, acting within the scope of their authority, engage in fraudulent practices, it is not necessary to pierce the corporate veil in order to establish liability. This principle was correctly applied in a case in which officers misrepresented facts to a purchaser. The court observed that "a corporation is vicariously liable for fraud and misrepresentation practiced by its directors or agents within the scope of their employment. A corollary to this rule is that said directors and agents are also liable individually." 

2. PROHIBITED TRANSFERS BY CORPORATION 

Three recent cases involved a statute prohibiting certain transfers by a financially embarrassed corporation. That statute prohibits a corporation which has refused to pay any of its notes or other obligations when due from transferring any of its property to any of its officers, directors or stockholders for the payment of any debt or upon any other consideration than the full value of the property paid in cash. The statute further provides that no conveyance by any such corporation shall be valid if made when it is insolvent or when insolvency is imminent, with the intent of giving a preference to any particular creditor. Directors or officers who violate the section may be held per-

28. Id. at 721. 
sonally liable to the creditors and stockholders of their corporation to the full extent of any loss sustained on account of the violation.

In the first of the three cases involving section 608.55, P Corporation, between April 15 and September 8, sold goods, wares and merchandise to D Corporation. On September 27 of the same year D Corporation became insolvent. Thereafter D Corporation made payments to a bank to which it had assigned all its accounts receivable prior to insolvency as collateral security for a loan. Additionally, C, an officer of D Corporation, had paid another corporate creditor from his personal funds. P Corporation sought to hold the officers and directors of D Corporation personally liable to the extent of these payments.

With respect to the payments to the bank, the court held that since the "transfer" was completed at the time of the assignment of the accounts receivable, it was not an invalid preferential payment within the meaning of the statute. With respect to the payment from the officer's personal funds, inasmuch as there was no diminution of the corporate assets, it was held that no preferential payment had been made. The court's reasoning is sound on both counts.

Another case involving this statute presented the question of whether an agreement at the time of the creation of an obligation that it will be secured by a mortgage or security deed, and to be followed by the execution and delivery of the mortgage or security deed at some later date, places the obligation in the category of an antecedent debt so as to invalidate the security as a preferential payment within the meaning of the statute.

The facts of the case reveal that B, an officer of D Corporation, made a number of loans to that corporation. Subsequently, he received from D Corporation a blanket mortgage on three lots and a note for 50,000 dollars payable on demand and bearing no interest. When later B received a deed to the three lots, he sought a declaration that the deed was a valid conveyance, or in the alternative, of foreclosure if the deed were found to have been given for security. This claim was resisted on the ground that both the mortgage and deed were invalid transfers within the meaning of the statute. Although the court found, that the financial condition of D Corporation was such that the statute prohibited a transfer to an officer for an antecedent debt, it held that the obligation was not an antecedent debt within the meaning of the statute and that the deed was given for a sufficient consideration.

The third case involving the statute underscores the principle that any gift of or excess over the fair market value of property conveyed

by an insolvent corporation to one of its officers represents a preference which the officer is required to repay to the corporation for the benefit of its creditors.

A related question is presented when preferential dividends are paid by a solvent corporation to a majority stockholder, to the exclusion of the remaining stockholders who do not ratify the transaction. Such was the situation presented in the case of Alliegro v. Pan Am. Bank of Miami.\footnote{37} Although acknowledging the general rule that dividends are not normally recoverable from stockholders once they are paid to them, the court correctly held the rule inapplicable when the stockholder received dividends which he knew were not paid pro rata to all stockholders.

3. PROFESSIONAL SERVICE CORPORATION ACT

At its 1961 session, the Florida legislature enacted the Professional Service Corporation Act,\footnote{38} the central purpose of which was to enable professional men to incorporate for the practice of their professions. Previously, professional and other self-employed groups were not permitted to incorporate, but in 1954 the Internal Revenue Code was amended to permit an employer to establish a pension fund for the benefit of his employees. The amendment provides that payments by the employer into the fund are deductible from his gross income. Moreover, payments to the employee do not subject him to income tax liability until actual receipt of the pension at a later date.\footnote{39}

Since its enactment cases construing this statute have involved attorneys,\footnote{40} accountants\footnote{41} and appraisers.\footnote{42} In holding that members of the Florida Bar may practice law as a corporate entity under the statute, the supreme court of Florida was careful to point out that “such approval is not to be construed as an intention to eliminate any of their obligations as individuals to meet the requirements of the Integration Rule and the Rules and Canons of Ethics.”\footnote{43} With respect to accountants, a rule of the state board of accountancy prohibiting certified public accountants or public accountants from being officers, directors, stockholders, representatives or agents of corporations engaged in the practice of public accounting was held to be null and void because in conflict
with the Professional Service Corporation Act. Similarly, in Parker v. Panama City, it was held that the legislative intent in enacting the statute was clearly to the effect that persons licensed as appraisers may incorporate and contract to render professional services.

4. DIRECTORS, OFFICERS AND AGENTS

It is a familiar principle of corporation law that knowledge acquired by officers or agents of a corporation while acting for the corporation may be imputed to the corporation. Thus, in a recent case a corporation was held liable for negotiations entered into by its general manager when other officers of the corporation were present during the negotiations and failed to repudiate his actions. Similarly, when a corporation which financed the first purchase of an automobile repossessed and resold it to a dealer and then financed the second sale of the automobile, which the dealer falsely represented to the plaintiffs to be new, the corporation was charged with knowledge of the misrepresentation.

The question of the liability of persons acting for corporations is governed by the general rule that a promoter is personally liable on contracts entered into by him on behalf of the corporation prior to its incorporation. Thus, in Katz v. Kenholts, a promoter was held personally liable as a party to a lease executed by him on behalf of a corporation which was not incorporated until five months later.

In another recent case, compensation was denied to an officer of a corporation who had no prescribed duties and who in fact never performed any duties, on the familiar principle that such payment by the corporation would amount to no more than a gift.

5. SHAREHOLDERS' RIGHTS

An interesting case recently decided by the Second District Court of Appeal involved the jurisdiction of state courts with respect to building and loan associations organized under the Federal Home Owners' Loan Act. The court held that since the Federal Home Loan Bank Board had adopted comprehensive rules and regulations governing the appointment of receivers and the calling of special meetings of the members of a federal building and loan association, the state courts had no jurisdiction in such matters. However, the court also held that

44. State Bd. of Accountancy v. Eber, supra note 41.
45. 151 So.2d 469 (Fla. 1st Dist. 1963).
47. Brown v. Cahill, 157 So.2d 871 (Fla. 3d Dist. 1963).
48. 147 So.2d 342 (Fla. 3d Dist. 1962).
49. Binz v. Helvetia Fla. Enterprises, 156 So.2d 703 (Fla. 3d Dist. 1963).
the federal authorities have not pre-empted the field and that the state courts have jurisdiction to invalidate proxies of federal building and loan association members, in the absence of federal provisions pertaining to the validity of proxies.

In *James Talcott, Inc. v. McDowell*, the court succinctly discussed the nature of a stockholder's derivative action, and correctly held that a complaint failed to state a cause of action for failing to allege: (1) that the corporation's refusal to sue was wrongful; and (2) the reasons for the refusal.

Section 17 of the Uniform Stock Transfer Law provides, in effect, that a restriction on the transfer of shares is invalid unless the restriction (or a proper reference to it) is stated upon the stock certificate. In *General Dev. Corp. v. Callin*, an employee of D Corporation, entered into a stock option agreement with the corporation. By the terms of this agreement, C represented that if he were to exercise the option he would acquire the stock for investment and not with a view to distribution. Subsequently, C gave notice of his desire to exercise the option, but D Corporation refused to deliver the stock without a restrictive legend on the stock certificate. C sued, alleging that he was entitled to receive the stock without the legend. The court correctly held that the aforementioned statute affected the obligations of C's contract, became a part of it, and that the stock certificate should be restricted accordingly. While not mentioned in the opinion, the real fear of D Corporation, of course, was that a resale of the shares by C would destroy the private offering exemption contained in the second clause of section 4(1) of the Securities Act of 1933, thereby placing the corporation in violation of the registration and prospectus provisions of that act.

6. DISSOLUTION AND RESTORATION

Section 608.35 of Florida's corporate code provides that a corporation which fails to comply with the reporting and capital stock tax requirements for six months shall not be permitted to maintain or defend any action in a Florida court until such reports are filed and the taxes paid. A recent case properly held that a corporation was not barred from maintaining an action by its failure to make reports and pay the capital stock tax, when such taxes were paid and the reports

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51. 148 So.2d 36 (Fla. 3d Dist. 1962).
52. FLA. STAT. § 614.17 (1963).
53. 139 So.2d 901 (Fla. 3d Dist. 1962).
54. Query: Was C legally entitled to the option or the stock in the first place, in view of Florida’s blue sky law? See FLA. STAT. ch. 517 (1963). That statute contains no exemption for sales of securities to employees. Accordingly, in the absence of registration under the Florida blue sky law, if C was a Florida resident and not already a stockholder of D Corporation, no exemption would seem to be available.
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were filed prior to the court's decision on the defendant's motion to dismiss on those grounds.

In another recent case the president of a corporation executed a lease on its behalf after the corporation had been dissolved for failure to pay its capital stock taxes. Subsequently, the taxes were paid and the corporation's permit to do business was restored pursuant to a governing statute. The president was held not to be personally liable under the lease, on the ground that the payment of the delinquent taxes had the effect of ratifying and confirming the lease as though the corporation was not delinquent on the date of its execution. This decision is in line with the generally accepted view that statutes providing for dissolution and restoration, when complied with, restore the corporation as though it had never been dissolved and validate acts performed during the interim period.

II. SECURITIES REGULATION

A. Recent Legislation

A major point of departure between the Federal Securities Act of 1933 and most of the state “Blue Sky” laws is the fact that the basic philosophy of the 1933 act is one of full disclosure, while that of the majority of the latter acts is one of examination of the merits of the securities proposed to be offered to the public. In short, the 1933 act is a “truth in securities” law designed to protect investors against misrepresentation and fraud in the offer and sale of securities. But as long as the whole truth is told, the Securities and Exchange Commission, the body charged with the duty of administering the 1933 act, is powerless to pass upon the merits of securities proposed to be offered to the public. On the other hand, many state securities commissions, including that of Florida, do pass upon the merits of securities proposed to be offered to their residents. From this fact has stemmed an incorrect (but perhaps understandable) belief on the part of many investors that a proposed issue “cleared” by the Florida Securities Commission has obtained the stamp of approval of that Commission and thus is somehow “safe.” Nothing could be further from the truth. Although the Florida Securities Act does set up certain standards as conditions precedent to registration of securities in Florida, and although the Florida Securities Commission does pass upon the merits of securities proposed to be offered, in the light of those statutory norms, favorable action

56. Spector v. Hart, 139 So.2d 923 (Fla. 2d Dist. 1962).
59. Fla. Stat. § 517.09(7) (1963) allows the sale of a security if the registrant can demonstrate that the sale would not work or tend to work a fraud on the purchaser, that the terms of the sale would be fair, just and equitable, and that the issuer's business or enterprise is not based upon unsound business principles.
by the Commission does not by any means constitute its recommendation or approval. A 1963 amendment to the Florida Securities Act makes unlawful any representation to the contrary.

Other new provisions added in 1963 include: (1) the granting of power to the court to appoint receivers at the request of the Commission as an aid in the enforcement of injunctive orders; (2) the deletion of the sale of insured mortgages from the list of exempt transactions and the addition of the requirement of a $25 fee to accompany notice of certain exempt transactions; (3) the deletion of provision for notice by registered dealers of their intention to sell registered securities; (4) authorization of the suspension of certain dealers' and salesmen's registrations; and (5) authorization for destruction of certain records by the Commission after such records have been photographed.

A welcome innovation is the publication, in printed form, of the Commission's rules and regulations. Heretofore, these rules and regulations had been mimeographed and distributed sporadically. Their collection in a single pamphlet will be of considerable assistance to attorneys.

B. Recent Cases

The Florida Securities Act requires registration of securities which are publicly offered for sale, but exempts certain transactions from registration. In Hammond v. State defendant was convicted of the felonious sale of unregistered securities, the trial court holding as a matter of law that there was no exemption available. On appeal this holding was reversed, on the ground that the question of the availability of the exemption was one for the jury.

In State v. Smith, a case of first impression in Florida, the question was presented whether scion is a necessary element for establishing a violation of the Florida Securities Act. The defendant was prosecuted for the unlawful sale of registered securities, but the indictment did not allege scion. The statute does not specify scion as an element of the crime, but the court held that the indictment was fatally defective, on the ground that scion is "an implied element of the crime which must be averred and proven. . .".

60. Fla. Stat. § 517.311 (1963). Representations by brokers or dealers that registration spells Commission approval are also made unlawful.
67. 151 So.2d 872 (Fla. 2d Dist. 1963).
68. 151 So.2d 889 (Fla. 1st Dist. 1963).
69. Id. at 891.
In *Harrison v. McCourtney*, the plaintiffs participated in and had knowledge of the violation alleged in the complaint; the defendant's answer, therefore, quite naturally raised the affirmative defense of estoppel. The court held that in an action based on a violation of the statute, estoppel may be a defense, thus creating a genuine issue of fact precluding a summary judgment. However, the affirmative defense of estoppel may be overcome if the plaintiff shows that he lacks sufficient control over a contact with the issuer of the stock.

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70. 148 So.2d 53 (Fla. 2d Dist. 1963). See also Popper v. Havana Publications, Inc., 122 So.2d 247 (Fla. 3d Dist. 1960).

71. Monroe v. Dixon, 152 So.2d 744 (Fla. 3d Dist. 1963).