

VI. Corporations

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Five cases decided by the courts and several significant pieces of legislation adopted by the Indiana General Assembly during the survey period warrant discussion.¹

A. Insider Security Transactions

Perhaps the most significant case decided during the survey period, and arguably the most unfortunate, was not decided by an Indiana court but rather by the United States Court of Appeals for the Seventh Circuit purporting to apply Indiana law. In *Freeman v. Decio*,² the court affirmed an order granting summary judgment for the defendants in a derivative action brought against certain officers and directors of a publicly held corporation for allegedly using material inside information as the basis for trading shares of the corporation.³ The plaintiff also alleged that one defendant had engaged in "short swing" trading in violation of section 16(b) of the 1934 Act.⁴

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¹One decision with Indiana connections decided during the survey period is worthy of a passing reference. *Indiana Nat'l Bank v. Mobil Oil Corp.*, 578 F.2d 180 (7th Cir. 1978), affirmed a judgment for Mobil in an action brought by banks representing offerees in a tender offer for the securities of Marcor, Inc. *Id.* at 187. The plaintiff banks contended that Mobil was obligated under §§ 14(d)(6) and 14(e) of the Securities Exchange Act of 1934, 15 U.S.C. § 78(d)(6), (e) (1976) [hereinafter referred to as the 1934 Act] to accept the tendered shares. The court of appeals rejected this contention and held that because the banks had not deposited the securities within eight days of Mobil's "public announcement" of the number of shares it would purchase under the tender offer, as specified in the tender offer, Mobil was not obligated to accept late-tendered shares. 578 F.2d at 184. The main issue before the court was whether Mobil's issuance of a press release to the financial press constituted a "public announcement" which triggered the banks' obligation to deposit the shares. The court held: (1) The phrase "public announcement" has a generally accepted meaning in the securities field that would clearly encompass press releases, which sophisticated parties, such as the banks, should have known; (2) the banks were not entitled to individual notice of the obligation to deposit the shares; and (3) the publicity surrounding the press release was more than enough notice to alert the banks of their obligations. *Id.* at 185-87.

²584 F.2d 186 (7th Cir. 1978).

³*Id.* at 200.

⁴15 U.S.C. § 78p(b) (1976). Section 16(b) provides that [f]or the purpose of preventing the unfair use of [inside] information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such

The most important issue in *Freeman* was whether Indiana law permits a shareholder to maintain a derivative action against insiders who trade shares of the corporation on the basis of material inside, meaning nondisclosed, information. In effect, the principal question was whether Indiana would follow the New York Court of Appeals' landmark decision in *Diamond v. Oreamuno*,⁵ which established a common law right of a corporation to recover profits made by insiders using inside information, or the Florida Supreme Court's decision in *Schein v. Chasen*,⁶ which refused to adopt the innovative

issuer . . . within any period of less than six months . . . shall inure to and be recoverable by the issuer

Id. The justification for the harsh remedy of § 16(b), which applies to innocent statutory insiders as well as those who trade with manipulative intent, is the supposed *in terrorem* effect upon the latter. It is doubtful that § 16(b) has this effect, and it has been roundly criticized by commentators. See generally Bateman, *The Pragmatic Interpretation of Section 16(b) and the Need for Clarification*, 45 ST. JOHN'S L. REV. 772 (1971); Munter, *Section 16(b) of the Securities Exchange Act of 1934: An Alternative to "Burning Down the Barn in Order to Kill the Rats,"* 52 CORNELL L.Q. 69 (1966); Wu, *An Economist Looks at Section 16 of the Securities Exchange Act of 1934*, 68 COLUM. L. REV. 260 (1968).

Unfortunately, *Freeman* is somewhat muddy about which defendants were charged with violating § 16(b). At one point, the court refers to two of the defendants who were outside directors of the corporation, 584 F.2d at 187, but at another point, the opinion refers to one of the outside directors and an inside director who was an officer as well as a director of the corporation. *Id.* at 188. It appears that the first reference is in error. The officer-director who was charged with the § 16(b) violation apparently was not charged with trading on inside information, and hence he would not have been a party to the suit if there had not been an alleged § 16(b) violation. This supposition is supported by the fact that the only discussion in the opinion of the potential § 16(b) violation pertained to the summary judgment entered in favor of the inside director. See discussion at note 42 *infra*. It seems that the district court did not consider or rule on the § 16(b) claim against the outside director. 584 F.2d at 188 n.2. This conclusion, however, is not absolutely clear because in still another portion of the opinion, the court stated that the fourth defendant, the inside director, was alleged to have made sales and gifts of stock at various times knowing that the financial data for the corporation were misstated. *Id.* at 197. It is not certain whether the complaint was ambiguous or the opinion poorly written.

⁵24 N.Y.2d 494, 248 N.E.2d 910, 301 N.Y.S.2d 46 (1969). *Diamond* generated considerable interest and, contrary to the inference that can be drawn from the footnotes in *Freeman*, generally favorable comment in legal journals. See, e.g., Note, *A Comparison of Insider Liability Under Diamond v. Oreamuno and Federal Securities Laws*, 11 B.C. INDUS. & COM. L. REV. 499 (1970); Note, *Insider Trading on Undisclosed Corporate Information: Diamond v. Oreamuno*, 22 ME. L. REV. 283 (1970); Note, *Diamond v. Oreamuno: A Fresh Approach to Insider Trading and the Duties of the Corporate Fiduciary*, 31 U. PITT. L. REV. 296 (1969); 37 FORDHAM L. REV. 477 (1969); 83 HARV. L. REV. 1421 (1970); 18 J. PUB. L. 493 (1969); 45 NOTRE DAME LAW. 314 (1970); 23 SW. L.J. 921 (1969); 55 VA. L. REV. 1521 (1969); 22 VAND. L. REV. 1412 (1969); 1970 WIS. L. REV. 576. See also Note, *Common Law Corporate Recovery for Trading on Non-Public Information*, 74 COLUM. L. REV. 269 (1974).

⁶313 So. 2d 739 (Fla. 1975), discussed in 28 U. FLA. L. REV. 223 (1975), and noted in 41 MO. L. REV. 589 (1976). *Schein* was initially decided by the Second Circuit Court

ruling of *Diamond* in a fact situation that would have required an expansive reading of *Diamond* to impose liability.

The *Freeman* decision is unfortunate in two major respects. First, at a time when the protection afforded security owners under the federal securities laws is being drastically curtailed by the United States Supreme Court,⁷ the court decided that Indiana would follow the status quo approach of Florida, a basically noncommercial state, rather than the innovative approach of New York, the most important commercial state in the country, in developing the common law to meet a changing social need. The second unfortunate aspect of *Freeman* is that the court really did not have to decide whether Indiana would adopt the *Diamond* view because an alternative holding of the trial court, affirmed by the court of appeals, was that the defendants *had not traded* on material inside information.⁸ Thus, the court could have and should have relied on the alternative ground to keep the issue open until it could be ruled on by an Indiana court.

In fact, the Seventh Circuit specifically declined to employ the certified question rule of the Indiana Rules of Appellate Procedure⁹ because it "agree[d] with the district court's conclusion that there [was] no factual basis for the plaintiff's allegations that the defendants sold Skyline stock on the basis of inside information . . ."¹⁰ Certainly, the Seventh Circuit had precedent for using this pro-

of Appeals as a diversity case. *Schein v. Chasen*, 478 F.2d 817 (2d Cir. 1973), *vacated and remanded sub nom. Lehman Bros. v. Schein*, 416 U.S. 386 (1974). The Second Circuit's decision in *Schein* also generated considerable, although not necessarily favorable, comment in legal journals. See Note, *Tippee Liability Under Common Law*, 11 HOUS. L. REV. 200 (1973); Note, *From Brophy to Diamond to Schein: Muddled Thinking, Excellent Result*, 1 J. CORP. L. 83 (1975); Note, *"Tippee" Liability Extended to Remote Third Parties*, 53 NEB. L. REV. 279 (1974); Note, *Restitution as a Common Law Basis for Holding an Outside Nontrading Tippee Liable for Tippee Profits*, 24 SYRACUSE L. REV. 1369 (1973); Note, *Securities Fraud Under State Common Law: Schein v. Chasen—Expanding Liability for the Tippee and Tippee*, 45 U. COLO. L. REV. 519 (1974); 40 BROOKLYN L. REV. 1334 (1974); 53 B.U.L. REV. 1150 (1973); 42 FORDHAM L. REV. 211 (1973); 87 HARV. L. REV. 675 (1974); 45 MISS. L.J. 260 (1974); 48 ST. JOHN'S L. REV. 415 (1973); 5 ST. MARY'S L.J. 834 (1974); 48 TULANE L. REV. 166 (1973); 26 VAND. L. REV. 1337 (1973); 19 VILL. L. REV. 533 (1974); 13 WASHBURN L.J. 534 (1974).

⁷See, e.g., *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462 (1977); *Piper v. Chris-Craft Indus., Inc.*, 430 U.S. 1 (1977); *TSC Indus., Inc. v. Northway Inc.*, 426 U.S. 438 (1976); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976); *Foremost-McKesson, Inc. v. Provident Sec. Co.*, 423 U.S. 232 (1976); *Rondeau v. Mosinee Paper Corp.*, 422 U.S. 49 (1975); *United Hous. Foundation, Inc. v. Forman*, 421 U.S. 837 (1975); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975); *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582 (1973); *Reliance Elec. Co. v. Emerson Elec. Co.*, 404 U.S. 418 (1972).

⁸584 F.2d at 200.

⁹IND. R. APP. P. 15(O).

¹⁰584 F.2d at 189 n.8.

cedure because *Gabhart v. Gabhart*,¹¹ in which the Indiana Supreme Court held that Indiana law protects minority shareholders through judicial review of corporate squeeze-out mergers,¹² was a certified question. Thus, in *Gabhart* the Seventh Circuit was willing to utilize the procedure to determine an important issue of Indiana law, but in *Freeman* the court declined to do so because, if the opinion can be taken at face value, it really did not have to decide the question. If the issue was so important that the Seventh Circuit felt compelled to decide it when an alternative holding was available, the issue certainly was important enough to certify to the Indiana Supreme Court.

It is difficult to fathom why the Seventh Circuit was unwilling to utilize the certified question procedure.¹³ A reading of *Freeman*, however, discloses an extraordinary antipathy toward the development and evolution of common law protection of shareholder interests that approaches an attitude of trying to stop the development of any "newfangled" law in this area. Perhaps the court, in its hostility toward *Diamond*, felt that if the issue had been presented to the Indiana Supreme Court, which had taken a major step in protecting the interests of minority shareholders in *Gabhart*, the Indiana court might have adopted the *Diamond* approach. If so, this is the view of Professor Manne with a vengeance.¹⁴

The *Freeman* complaint alleged that the defendant directors had breached their fiduciary duties to Skyline Corporation by trading in its stock on the basis of material nonpublic information acquired by virtue of their official positions, and further alleged that the directors should be compelled to account to Skyline in a derivative action for the profits from those transactions.¹⁵ The Seventh Circuit indicated that the only case brought to its attention which raised the question whether *Diamond* would be followed in another jurisdiction was *Schein*. Apparently, the court was unaware that the Second Circuit, which initially decided in *Schein* that Florida would adopt *Diamond*, declined to extend the doctrine to a principal shareholder of a corporation who was neither an officer nor a director.¹⁶

¹¹370 N.E.2d 345 (Ind. 1977).

¹²*Id.* at 353.

¹³*Schein* was certified to the Florida Supreme Court by the Second Circuit after it was vacated and remanded by the Supreme Court. 313 So. 2d 739 (Fla. 1975). The Second Circuit's decision in *Schein* has been called result oriented, with the court taking the position that a remedy should exist for a wrong. See 40 BROOKLYN L. REV. 1334, 1344 (1974).

¹⁴See discussion at note 19 *infra* and accompanying text.

¹⁵584 F.2d at 186. The profits would be the difference between the price realized by the defendants and the price of the stock after the adverse developments were disclosed.

¹⁶*Frigitemp Corp. v. Financial Dynamics Fund, Inc.*, 524 F.2d 275 (2d Cir. 1975).

An understanding of *Freeman* requires an understanding of *Diamond*. *Diamond* was a derivative action by a shareholder of Management Assistance, Inc. (MAI) charging that two of the defendants, the chairman of the board and the president, sold MAI shares before a substantial decline in the net earnings of the corporation was announced. A precipitous decline in the price of the stock followed the disclosure of the drop in earnings. The New York Court of Appeals reasoned that “a person who acquires special knowledge or information by virtue of a confidential or fiduciary relationship . . . [cannot] exploit that knowledge or information for his own personal benefit but must account to his principal for any profits”¹⁷ To the court, this was “merely a corollary to the broader principle, inherent in the nature of the fiduciary relationship, that prohibits a trustee or agent from extracting secret profits from his position of trust.”¹⁸

Diamond presented the court with a situation in which the acts of the defendants were admittedly wrongful but the corporation had not suffered injury or damage. The defendants argued that because the corporation was not “damaged” and was unaffected by their actions, it should not be permitted to recover the proceeds and, consequently, a derivative action was inappropriate.¹⁹ The court rejected this contention, reasoning that an allegation of damage to the corporation was not an essential requirement for a cause of action founded on a breach of fiduciary duty.²⁰ When fiduciary duties are involved, the law does not merely compensate the plaintiff, here the corporation represented by the shareholder, for the defendant’s wrongs but also attempts to prevent wrongs “by removing from agents and trustees all inducement to attempt dealing for their own benefit in matters which they have undertaken for others, or to which their agency or trust relates.”²¹ In effect, the information on MAI’s declining fortunes was treated as an “asset,” which could not be used by a fiduciary despite a lack of injury to the corporation.

The court was mainly interested in the relationship between the corporation and the defendants rather than of the relationship between the defendants and the unknown persons who might have purchased their shares over the stock exchange. The court reasoned:

Thus, the Second Circuit recognized the limits of *Diamond* even before *Schein* was decided.

¹⁷24 N.Y.2d at 497, 248 N.E.2d at 912, 301 N.Y.S.2d at 80.

¹⁸*Id.* at 497-98, 248 N.E.2d at 912, 301 N.Y.S.2d at 80.

¹⁹For a discussion of the nature of shareholder derivative actions, see generally H. HENN, HANDBOOK OF THE LAW OF CORPORATIONS §§ 358-360 (2d ed. 1970); 2 G. HORNSTEIN, CORPORATION LAW & PRACTICE §§ 711, 716, 734 (1959); Hornstein, *The Shareholder's Derivative Suit in the United States*, 1967 J. BUS. L. 282.

²⁰24 N.Y.2d at 498, 248 N.E.2d at 912, 301 N.Y.S.2d at 81.

²¹*Id.*, 248 N.E.2d at 912, 301 N.Y.S.2d at 81 (quoting *Dutton v. Willner*, 52 N.Y. 312, 319 (1873)).

The primary concern, in a case such as this, is not to determine whether the corporation has been damaged but to decide, as between the corporation and the defendants, who has a higher claim to the proceeds derived from the exploitation of the information. In our opinion, there can be no justification for permitting officers and directors, such as the defendants, to retain for themselves profits, which it is alleged, they derived solely from exploiting information gained by virtue of their inside position as corporate officials.²²

The *Freeman* court did not believe Indiana would take a similar position. The court reluctantly acknowledged the conventional wisdom that insider trading should be deterred although it may lessen the "efficiency" of the capital allocation function of the securities markets.²³ Clearly, the court would prefer to follow the views of the foremost advocate of the benefits of "insider trading," Professor Henry Manne, who suggests that insiders *should* be allowed to trade freely on inside information and that such a right "may be fundamental to the survival of our corporate system."²⁴ Professor Manne asserts that such trading helps the market because the appropriate price for stock is determined on the basis of the best information available and that the best information is possessed by insiders. Essentially, Professor Manne is arguing that insider trading is a useful device for compensating the true entrepreneurs in a corporation in which traditional forms of compensation might not be adequate. Admittedly, allowing an inside innovator who has participated in a new development that will increase the value of his company's shares to take advantage of the uninformed public has some appeal. Although allowing an innovator to be compensated by a shareholder who sells without knowledge of the potential development might be justified—even though the corporation itself should perhaps pay the innovator his worth, it is difficult, if not impossible, to justify a rule permitting defendants such as those in *Diamond* and *Freeman* to "bail out" before news of *adverse* developments becomes public. In effect, the *Freeman* court has permitted such action by deciding that Indiana courts would not penalize insiders who benefited from nonpublic information of adverse developments to the corporation.

In begrudgingly accepting the proposition that insider trading should be discouraged, the *Freeman* court emphasized that section

²²24 N.Y.2d at 498, 248 N.E.2d at 912, 301 N.Y.S.2d at 81.

²³584 F.2d at 190.

²⁴H. MANNE, INSIDER TRADING IN THE STOCK MARKET 110 (1966). As the *Freeman* court notes, Professor Manne's views are quite controversial. 584 F.2d at 190 n.12.

16(b) of the 1934 Act was a response to abuse of inside information and noted that the Securities and Exchange Commission (SEC) has also utilized the powers granted under section 15(c)(1) of the 1934 Act²⁵ and SEC Rule 10b-5²⁶ to police insider trading.²⁷ The court further noted that “victims” of insider trading may recover damages under the common law in some cases²⁸ under rule 10b-5, or even under provisions of state Blue Sky laws.²⁹ Unlike the *Diamond* court, however, the *Freeman* court did not feel that the existing remedies for controlling insider trading were inadequate. The court discussed the “victims” of insider trading in a lengthy footnote³⁰ and observed that there was considerable ambiguity about who should be considered a direct victim of insider trading. The court posited that although those persons who bought from or sold to insiders in impersonal market transactions might feel cheated, they probably would have traded even if the insiders had stayed out of the market. The court further reasoned, though, that persons who traded securities who would not have done so had the insiders made public their inside information might reasonably be considered victims.³¹ The problem with this approach is that it broadens the class of victims to include all persons who traded from the time that the insiders entered the market until the information became public, or at least includes all persons who traded at the same time as the insiders.³² This class could be enormous, yet the insiders would be liable to everyone. This is not a point in favor of the status quo approach; however, this is an argument in favor of *Diamond*. Under the approach taken by the *Diamond* court, rejected by *Freeman*, the issue is whether the insiders should keep their profits or disgorge them to the corporation. If the corporation recoups the profits, those persons who bought from insiders who were bailing out at least find their investment has appreciated in value to the extent of the profits, and

²⁵15 U.S.C. § 78o(c)(1) (1976).

²⁶17 C.F.R. § 240.10b-5 (1979). *See, e.g.*, SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968). The *Freeman* court also mentioned § 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a). 584 F.2d at 191. Although contrary to the court's implication, the likelihood of the present Supreme Court upholding a private right of action under that section is somewhat remote.

²⁷584 F.2d at 190.

²⁸*See, e.g.*, Strong v. Repide, 213 U.S. 419 (1909); Low v. Wheeler, 207 Cal. App. 2d 477, 24 Cal. Rptr. 538 (1962); Hotchkiss v. Fischer, 139 Kan. 333, 31 P.2d 37 (1934).

²⁹*See, e.g.*, IND. CODE § 23-2-1-12 (1976).

³⁰584 F.2d at 191 n.20.

³¹*Id.*

³²*See generally* Fleischer, *Securities Trading and Corporate Information Practices: The Implications of the Texas Gulf Sulphur Proceedings*, 51 VA. L. REV. 1271 (1965); Note, *Damages to Uninformed Traders for Insider Trading on Impersonal Exchanges*, 74 COLUM. L. REV. 299 (1974).

those persons who bought at the same time but not from the insiders also find that their investment has become more valuable. Nothing in *Diamond* suggests that insiders should be compelled to disclose adverse information as soon as it is available because there can be legitimate reasons for keeping it temporarily confidential, but when the insiders profit from that confidential knowledge, they should not be permitted to keep their wrongfully obtained gains.

The *Diamond* court relied heavily on the Delaware decision in *Brophy v. Cities Service Co.*,³³ which held that a corporation could recover the profits derived by a confidential secretary to a director of the corporation who, knowing that the corporation was about to enter the market to purchase its own shares, purchased shares and resold them at a profit to the corporation. The *Diamond* court also relied on section 388 of the *Restatement (Second) of Agency*,³⁴ which establishes the broad rule prohibiting an agent from taking advantage of a corporate opportunity.³⁵ The *Freeman* court rejected the premise that all inside information should be considered a corporate asset and posited that it would be better to inquire whether there was any potential loss to the corporation from the use of the information in insider trading. According to the court, the problem with *Diamond* was that the defendants' information was not potentially valuable to the corporation in its own right because the corporation itself could not exploit it in dealing in its own securities. Hence, the information was not an "asset," and it therefore could be exploited by an insider.³⁶ In an age of distrust of large corporations and lack of public interest in the securities market, such formalistic reasoning is appalling.

Even assuming that damage to the corporation³⁷ is a crucial element of a shareholder derivative action against insiders who have abused their position,³⁸ the *Diamond* court recognized that regard-

³³31 Del. Ch. 241, 70 A.2d 5 (1949), noted in 63 HARV. L. REV. 1446 (1950).

³⁴RESTATEMENT (SECOND) OF AGENCY § 388 (1957). See also *id.*, Comment c.

³⁵To be sure, trading on inside information is not the typical practice covered by § 388. See generally 37 FORDHAM L. REV. 477 (1969).

³⁶584 F.2d at 194.

³⁷The *Freeman* court distinguished *Brophy* on this ground. In *Brophy*, the corporation was directly injured because the defendant's purchase of corporate stock for his own account could force the price to rise, and hence the corporation would have to pay more for its shares than it otherwise would have to.

³⁸It should be noted that Florida, where *Schein* was decided, clearly requires damage to the corporation as a prerequisite for a shareholder derivative action. See *Palma v. Zerbey*, 189 So. 2d 510 (Fla. Dist. Ct. App. 1966), cert. denied, 200 So. 2d 814 (1967); *Citizen's Nat'l Bank v. Peters*, 175 So. 2d 54 (Fla. Dist. Ct. App. 1965); *Maronek v. Atlantis Hotel, Inc.*, 148 So. 2d 721 (Fla. Dist. Ct. App. 1963); *James Talcott, Inc. v. McDowell*, 148 So. 2d 36 (Fla. Dist. Ct. App. 1962). See generally 28 U. FLA. L. REV. 223, 230 (1975).

less of a lack of specific allegations of damage, harm to the corporation from the defendants' actions could be inferred. The court reasoned that the corporation "has a great interest in maintaining a reputation of integrity, an image of probity, for its management and in insuring the continued public acceptance and marketability of its stock."³⁹ The *Freeman* court considered any harm to the corporation from insider trading as "little different" from the harm that could be inferred whenever a corporate official committed an illegal or unethical act using a corporate asset, which lacks the "element of loss of opportunity or potential susceptibility to outside influence"⁴⁰ necessary to require an accounting to the corporation. Unfortunately, the court failed to recognize that there is a considerable difference between a situation in which an insider misuses an asset, even to the point of embezzling funds from the corporation, and one in which he *trades* on inside information. In the former, the distrust is likely to be directed at the individual *qua* individual rather than at the individual *qua* management of the corporation. In the latter situation, the public is likely to perceive that the ethical standards of the management as a whole are so low that they cannot be trusted not to take advantage of the *investing* public. This perception can hurt all shareholders: those who bought from the insiders without knowledge of the adverse information, those who bought from others without knowledge, and those who did not sell but maintained their stock position.

The *Freeman* court further questioned the *Diamond* analysis of potential double liability of defendants who may be personally liable to purchasers of their stock after disgorging their profits to the corporation. The court did not consider the resort to an interpleader action, suggested in *Diamond* as a means of binding injured investors to the judgment in an action to recover the fund,⁴¹ as an adequate solution to this problem. The court also rejected the *Diamond* contention that double liability should be imposed to more effectively deter insider trading and that double liability is justified analytically because the two causes of action, one on behalf of the investor and one on behalf of the corporation, are based on separate legal wrongs.⁴²

³⁹24 N.Y.2d at 499, 248 N.E.2d at 912, 301 N.Y.S.2d at 81 (1969), *quoted in* 584 F.2d at 194. *See also* Southwest Pump & Mach. Co. v. Forslund, 225 Mo. App. 262, 29 S.W.2d 165 (1930).

⁴⁰584 F.2d at 194.

⁴¹*Id.*

⁴²*Id.* at 195. *See generally* Conant, *Duties of Disclosure of Corporate Insiders Who Purchase Shares*, 46 CORNELL L.Q. 53 (1960); Note, *Common Law Corporate Recovery for Trading on Non-Public Information*, 74 COLUM. L. REV. 269 (1974).

The *Freeman* court concluded, in effect, that the *Diamond* court and the Second Circuit in *Schein* were not really concerned with double liability because the courts doubted that the investors—the true victims of insider trading—would be able to bring suit. Therefore, the possibility of double liability was purely theoretical to those courts.⁴³ The Seventh Circuit rejected this position, reasoning that effective remedies against insider trading have been developed subsequent to the *Diamond* decision. In this respect the court stated:

In spite of other recent developments indicating that such class actions would not become as easy to maintain as some plaintiffs had perhaps hoped, it is clear that the remedies for insider trading under the federal securities laws now constitute a more effective deterrent than they did when *Diamond* was decided.⁴⁴

Unfortunately, the *Freeman* court appears to be operating in a vacuum. The Supreme Court has not only made it more difficult for rule 10b-5 class actions to be brought but its decisions in the last few years display a decided hostility toward *any* shareholder actions under the rule.⁴⁵

Freeman is both tragic and ironic in this respect. The irony is that many of the expansive readings of rule 10b-5 by the lower federal courts were from a perceived inadequacy of the common law to protect the interests of investors in cases of insider trading. Because the Supreme Court has recently taken a position blocking further expansion of rule 10b-5, the only recourse shareholders have is through the development of the common law. The tragedy of *Freeman* is that the court clearly fails to recognize that the position of investors is worse, not better, than it was at the time of *Dia-*

⁴³584 F.2d at 195.

⁴⁴*Id.* at 195-96. The court cited *Eisen v. Carlisle & Jacquelin*, 386 U.S. 1035 (1967), and *Hochfelder v. Ernst & Ernst*, 425 U.S. 909 (1975). Presumably, the court was actually referring to the *Eisen* decision reported at 417 U.S. 156 (1974), because 386 U.S. 1035 reports a denial of certiorari in an earlier stage of the litigation, and was also referring to the *Hochfelder* decision reported at 425 U.S. 186 (1975). *Hochfelder* does not appear at 425 U.S. 909, but does appear at 425 U.S. 986, which only reports a denial of rehearing.

⁴⁵*See generally* cases cited note 6 *supra*. As one observed in discussing *Schein*, the Florida Supreme Court has acknowledged that

[w]hen new relations between men arise . . . law is called in to adjust them. Legal doctrines are predicated on reason and custom, mark their growth from rude beginnings, and, like the order of the universe, are constantly changing to adjust the new relations of society. We have no better proof of this than the development of our common law and system of equity.

41 MO. L. REV. 589, 595 (1976). *See also* 83 HARV. L. REV. 1421, 1432 (1970).

mond. The common law should be evolving to protect investors because of the decline of rule 10b-5, but the *Freeman* court states that the common law will not and does not have to expand because of the availability of the rule 10b-5 cause of action.

In fact, *Freeman* did not consider the possibility that the best remedy for trading on inside information on impersonal stock exchanges may be recovery solely by the corporation and not by investors who bought from or sold to the insiders. Arguably, investors who, by luck, can trace their transactions back to the insiders should not be favored over other investors who traded with noninsiders at the same time with the same degree of ignorance. By allowing the corporation to recoup the profits, all investors will be benefited.

The only Indiana decision discussed in *Freeman* was the early case of *Board of Commissioners v. Reynolds*,⁴⁶ in which it was held that a director does not have a duty to disclose inside information to a shareholder from whom he is buying stock.⁴⁷ The court noted that *Board of Commissioners* and *Diamond* could be distinguished because the former involved fiduciary duties owed to a selling shareholder whereas the latter involved a duty owed to the corporation. The *Freeman* court felt, however, that a jurisdiction that does not protect a selling shareholder from insider trading would be unlikely to create a cause of action in the corporation's favor. The court noted that Indiana had enacted securities laws containing an antifraud provision⁴⁸ since *Board of Commissioners* was decided, but it is not at all clear what relief would be available in the context of *Freeman* other than to the actual purchasers of the shares, if they could be determined. *Freeman* did recognize that *Board of Commissioners* was a thin reed indeed to support the court's position, because the court noted that there have been suggestions that *Board of Commissioners* be overruled.⁴⁹

The Seventh Circuit also agreed with the district court that the defendants had not, in fact, traded on the basis of inside information. This position should have been the sole ground for affirming the decision. There cannot be any valid argument on the point because there did not appear to be sufficient evidence constituting

⁴⁶44 Ind. 509 (1873).

⁴⁷*Id.* at 513.

⁴⁸IND. CODE § 23-2-1-12 (1976), cited in 584 F.2d at 191.

⁴⁹The court referred to Ryan, *Should Tippecanoe County Commissioners v. Reynolds be Overruled?*, 16 IND. L. J. 563 (1941), and noted that the court in *Krull v. Pierce*, 117 Ind. App. 638, 71 N.E.2d 617 (1947), believed it would be overruled. 584 F.2d at 196 n.41. *Krull*, however, does not seem to support this observation, desirable though it might be. The court apparently was unaware that the continuous authority of *Board of Comm'rs* appears to have been recognized in *Yorke v. Batman*, 376 N.E.2d 1211 (Ind. Ct. App. 1978).

“significant probative evidence tending to support the complaint”⁵⁰ to withstand a motion for summary judgment. The court upheld the propriety of considering evidence of the defendants’ past patterns of sales of the corporation’s shares and of their motivations for making the challenged sales.⁵¹ Although liability for trading on inside information would not be precluded merely because the defendants continued in a pattern of selling shares, the pattern would be relevant in determining whether the insiders were in fact trading on inside information.⁵²

Certain transactions objected to in the complaint could not have been based on inside information because the financial statements allegedly misstating the results for the fiscal period in question were not prepared until the period was over. Furthermore, certain allegations by the plaintiff concerning the accuracy of the financial statements could not stand up to the defendants’ evidence explaining the financial results. With respect to the second period during which insider trading was alleged, the court recognized that the decline in the company’s earnings was not known to the defendant directors as an “accounting fact” before the end of the quarter in question, unlike the situation in *Diamond*, and found that certain supposed “inside information” was in fact public knowledge.⁵³ In other words, the allegations that the defendants were trading on inside information were pure conjecture.⁵⁴

The Seventh Circuit also held that the failure to disclose predictions of the company’s future prospects was not a nondisclosure of material inside information under the circumstances of the case and that this conclusion was appropriate in either the *Diamond* type cause of action or under rule 10b-5.⁵⁵ Although the author clearly disagrees with the *Freeman* conclusion that *Diamond* would be rejected in Indiana, suits should not be allowed when an earnings prediction, which is unsupported by hard information on earnings, sales, or costs, was not disclosed.⁵⁶

⁵⁰584 F.2d at 196-97 (citing *First Nat’l Bank v. Cities Serv. Co.*, 391 U.S. 253, 290 (1967)).

⁵¹584 F.2d at 197.

⁵²*Id.* n.44. The court recognized that an adverse inference of bailing out on the basis of inside information can be drawn against an insider who suddenly sells a significant portion of his holdings if material adverse information about the corporation subsequently becomes public, but the court further recognized that the inference could be nullified if the sales in question were consistent in timing and amount with past patterns or if other circumstances might reasonably account for the sale.

⁵³*Id.* at 199-200.

⁵⁴Admittedly, *Diamond* involved a motion to dismiss whereas *Freeman* involved a motion for summary judgment.

⁵⁵See generally 3 A. BROMBERG, SECURITIES LAW: FRAUD § 8.2, at 197-98 (1977).

⁵⁶The *Freeman* court also affirmed the summary judgment for the director who was charged with insider trading in violation of § 16(b) of the 1934 Act. The plaintiff

B. Representation of Corporations

*State ex rel. Western Parks, Inc. v. Bartholomew County Court*⁵⁷ is an interesting decision involving the propriety of nonattorneys representing corporations in legal proceedings. The Indiana Supreme Court held that Indiana Code section 34-1-60-1, which provides that corporations organized under the Indiana General Corporation Act⁵⁸ and the four professional corporation acts⁵⁹ “need not appear by attorney in civil cases filed on a small claims docket of a circuit, superior or county court,”⁶⁰ was without force or effect, and that “a corporation must be represented by legal counsel in a small claims court proceeding.”⁶¹ Consequently, the court made permanent an alternative writ of mandate and prohibition ordering the respondent, Bartholomew County Court, to refrain from exercising further jurisdiction over the law suit involved in the controversy until either legal counsel appeared on behalf of the plaintiff corporation or the case was dismissed.⁶²

The controversy had its origins in an action filed by Remove All, Inc. against the relator, Western Parks, Inc. The claim was filed by Remove All's office manager who was not an attorney admitted to practice in Indiana. The relator moved to dismiss the action alleging improper venue, but this motion was overruled and the matter was set for trial.⁶³ A default judgment was entered when Western Parks failed to appear at trial. Western Parks also did not appear at a hearing on a motion for proceedings supplemental filed by Remove All's office manager. At or subsequent to that hearing, another non-attorney employee of Remove All signed an application for contempt citation, and the respondent ordered the relator to appear and show cause why it should not be attached and cited for contempt. The contempt hearing was continued, but prior to the new date the relator,

contended that the insider was liable because the restrictions against resale of the stock had expired within six months of the time it was sold. The court rejected this view, and held that the stock was acquired when he became committed to take and pay for it, not when the restrictions lapsed. 587 F.2d at 200. See *Silverman v. Landa*, 306 F.2d 422, 424 (2d Cir. 1962); *Blau v. Ogsbury*, 210 F.2d 426, 427 (2d Cir. 1954). This position is true, although the certificates would not be delivered to the director until the restrictions have lapsed.

⁵⁷383 N.E.2d 290 (Ind. 1978).

⁵⁸IND. CODE §§ 23-1-1-1 to -12-4 (1976 & Supp. 1979).

⁵⁹*Id.* §§ 23-1-13-1 to -11 (1976) (General Professional); *id.* §§ 23-1-13.5-1 to -6 (1976) (Professional Accounting); *id.* §§ 23-1-14-1 to -21 (1976 & Supp. 1979) (Professional Medical); *id.* §§ 23-1-15-1 to -21 (1976) (Professional Dental).

⁶⁰*Id.* § 34-1-60-1 (1976).

⁶¹383 N.E.2d at 293.

⁶²*Id.* at 291.

⁶³Although it is not indicated in the opinion, presumably the relator appeared by counsel in moving to dismiss.

by counsel, filed a motion to set aside the default judgment and an alternative motion for an order requiring Remove All to appear through legal counsel or have the action dismissed. Both motions were overruled. The relator then petitioned the supreme court to issue the alternative writ of mandate and prohibition. The reported decision made permanent the temporary writ granted by the court.⁶⁴

The issue before the court was the validity of the 1976 amendment to the Indiana Code of Civil Procedure excepting cases in which a corporation was involved in an action brought in small claims court from the general rule that a corporation must appear in court through counsel.⁶⁵ Justly protective of the constitutional mandate giving the court original jurisdiction to determine the qualifications for admissions and practice of law,⁶⁶ the court held that the statutory provision purportedly allowing corporations to appear by nonattorneys was in conflict with the rules governing the qualifications precedent to the practice of law in Indiana and thus was without force or effect.⁶⁷ The basis of this position was, of course, the doctrine of separation of powers.⁶⁸

After rejecting the authority of the legislature to authorize lay persons to represent corporations in small claims proceedings, the court proceeded to determine whether under its rules a nonattorney could represent a corporation. The court noted that although some rules of small claims courts provide that a party "may appear either in person or by attorney,"⁶⁹ the rules are silent about whether a corporation may appear by an agent who is not a licensed attorney. The court cited a number of decisions from other jurisdictions, particularly Illinois, as establishing the rule that the agent representing the corporation must be an attorney.⁷⁰ The court also noted that

⁶⁴383 N.E.2d at 293.

⁶⁵See Act of Feb. 26, 1976, Pub. L. No. 132, § 44, 1976 Ind. Acts 655 (codified at IND. CODE § 34-1-60-1 (1976)).

⁶⁶IND. CONST. art. 7, § 4. See also IND. R. APP. P. 4(A)(1)-(3); IND. R. ADMISS. & DISCP. 3, 24.

⁶⁷383 N.E.2d at 293. See IND. CODE § 34-5-2-1 (1976); *In re Public Laws Nos. 305 & 309*, 263 Ind. 506, 334 N.E.2d 659 (1975); *State ex rel. Blood v. Gibson Circuit Court*, 239 Ind. 394, 157 N.E.2d 475 (1959).

⁶⁸383 N.E.2d at 292 (citing *State ex rel. Indiana State Bar Ass'n v. Moritz*, 244 Ind. 156, 191 N.E.2d 21 (1963)).

⁶⁹383 N.E.2d at 292. See, e.g., IND. R. SM. CL. 2(B)(5).

⁷⁰383 N.E.2d at 292 (citing *SEC v. Research Automation Corp.*, 521 F.2d 585 (2d Cir. 1975); *James v. Daley & Lewis*, 406 F. Supp. 645 (D. Del. 1976); *Nicholson Supply Co. v. First Fed. Sav. & Loan Ass'n*, 184 So. 2d 438 (Fla. Dist. Ct. App. 1976); *National Bank of Austin v. First Wis. Nat'l Bank*, 53 Ill. App. 3d 482, 368 N.E.2d 119 (1977); *Tom Edwards Chevrolet, Inc. v. Air-Cel, Inc.*, 13 Ill. App. 3d 378, 300 N.E.2d 312 (1973); *Remole Soil Serv., Inc. v. Benson*, 68 Ill. App. 2d 234, 215 N.E.2d 678 (1966)). Cf. *Johnson v. Pistakee Highlands Community Ass'n*, 390 N.E.2d 640 (Ill. App. Ct. 1979) (corporate officer's preparation of claim did not constitute practice of law). In *National*

some jurisdictions have expressly extended the rule to small claims court.⁷¹ Interestingly, the court did not cite its own decision in *State Bank v. Bell*,⁷² which contained dictum that a corporation must appear by an attorney.⁷³ Nor did it cite *Jefferson Park Realty Corp. v. Kelley, Glover & Vale*,⁷⁴ in which it was held that in the context of service and appearance the term "attorney" meant any person authorized to appear and represent a party to an action.⁷⁵ The court also held that when an officer of a corporation on whom service might be made waived issuance and service of summons to a complaint and filed an answer and general denial, the trial court had jurisdiction over the corporation and the resulting judgment was binding on the corporation.⁷⁶

The *Western Parks* court reasoned that a corporation should not be permitted to appear by "itself" even though an individual may do so if he or she pleases. The court further reasoned that the individual appearing pro se has a personal stake in the outcome of the litigation as both a party litigant and as an individual. A corporation, however, cannot be identified entirely with any one individual because the corporation is an independent legal entity separate and apart from its shareholders, officers, and agents. Thus, any agent representing the corporation would have only an indirect stake in the law suit.⁷⁷

The court was clearly concerned that confusion may arise when a corporation appears and is represented by several agents at different stages of the proceedings, as was the case with the plaintiff in *Western Parks*. The court asserted that a lack of legal expertise

Bank of Austin, the issue was whether a partner could represent a partnership in court. The court held that the partner could not because a lay agent cannot appear for a principal. 53 Ill. App. 3d at 489, 368 N.E.2d at 125.

⁷¹383 N.E.2d at 292 (citing *Tom Edwards Chevrolet, Inc. v. Air-Cel, Inc.*, 13 Ill. App. 3d 378, 300 N.E.2d 312 (1973)). See also *Tuttle v. Hi-Land Dairyman's Ass'n*, 10 Utah 2d 195, 350 P.2d 616 (1960).

⁷²5 Blackf. 127 (Ind. 1839).

⁷³*Id.*

⁷⁴105 Ind. App. 313, 12 N.E.2d 977 (1938).

⁷⁵*Id.* at 321, 12 N.E.2d at 981.

⁷⁶*Id.* at 322, 12 N.E.2d at 981.

⁷⁷See *Madding v. Indiana Dept. of State Revenue*, 149 Ind. App. 74, 270 N.E.2d 771 (1971). See generally H. HENN, *supra* note 19, § 78. This is always theoretically the case, but the proposition may be questioned because the small corporation with one director who is "in fact" the corporation is such a commonplace occurrence. Of course, the court has to think in terms of all corporations and not just the one-person corporation. It might be difficult to formulate a rule permitting the small, solely-owned corporation to appear by the person who owns and controls it while requiring the large corporation to appear by counsel. The problem is not as pronounced with the one-person corporation or the giant corporation, but with corporations having two or three principals, the identity of interest is not as clear.

by these persons "combined with a failure to maintain a proper chain of communication"⁷⁸ might frustrate the judicial process. To be sure, problems can arise even when different attorneys who are members of the same law firm appear for a corporation at various stages in a judicial proceeding, but the likelihood of problems occurring is, or should be, much less in this situation if the attorneys are true professionals. There is little doubt that lay persons representing corporations can disrupt the judicial process.⁷⁹

In two recent cases courts in other jurisdictions have reversed condemnation awards in favor of corporations represented by nonattorneys because the lack of legal expertise of the nonattorneys resulted in the improper admission of evidence.⁸⁰ These cases were not cited in *Western Parks*, but they support the court's proposition that the nonattorney representative of a corporation can "frustrate the continuity, clarity and adversity which the judicial process demands."⁸¹ Because sizable condemnation awards were reversed, these two decisions are somewhat embarrassing to attorneys. In effect, the appellate courts were telling the defendant landowners that they should have been represented by attorneys whose legal training, skills, and expertise would have resulted in smaller judgments for the taking of their property.

The decisions holding that a corporation must appear by an attorney in small claims courts are not unanimous. In *Dixon v. Reliable Loans, Inc.*,⁸² the Georgia Court of Appeals, recognizing the intent behind the Georgia statute concerning the practice of law, held that a corporation could sue without an attorney.⁸³ In *Brooks v. Small Claims Court*,⁸⁴ the California Supreme Court held that corporations can appear without an attorney in the California small claims courts.⁸⁵ The court noted that the poor and unexperienced litigant would still be at a disadvantage against a skilled corporate representative if the provision designed to aid the poor litigant and provide equality for all small claims litigants keeps him from obtaining counsel.⁸⁶

⁷⁸383 N.E.2d at 293.

⁷⁹Of course, this is also true when individuals represent themselves, but then that is an individual's right.

⁸⁰*City of DeKalb v. Nehring Elec. Works, Inc.*, 40 Ill. App. 3d 726, 353 N.E.2d 150 (1976); *City of Akron v. Hardgrove Enterprises, Inc.*, 47 Ohio App. 2d 196, 353 N.E.2d 628 (1973).

⁸¹383 N.E.2d at 293.

⁸²112 Ga. App. 618, 145 S.E.2d 771 (1965).

⁸³*Id.* at 620, 145 S.E.2d at 772.

⁸⁴8 Cal. 3d 661, 504 P.2d 1249, 105 Cal. Rptr. 785 (1973).

⁸⁵*Id.* at 669, 504 P.2d at 1254, 105 Cal. Rptr. at 790.

⁸⁶*Id.*, 504 P.2d at 1254-55, 105 Cal. Rptr. at 790-91.

The result reached in *Western Parks*, that corporations must be represented by licensed attorneys in small claims courts, is certainly defensible as an abstract matter, although there are arguments in favor of eliminating the requirement in small claims courts, which are intended to be simple and uncomplicated mechanisms for resolving small disputes.⁸⁷ It is doubtful, however, that *Western Parks* was the right case for such a determination. Arguably, *Western Parks* had waived any objection to nonattorneys appearing and representing Remove All. *Western Parks* no doubt was represented by an attorney at the outset of the proceedings and when *Western Parks* filed its motion to dismiss for improper venue, no objection to a nonattorney representing the corporation was raised. In fact, *Western Parks* did not raise the objection until after the default judgment had been entered.⁸⁸ The appropriate time to have raised the objection was at the outset of the proceeding, not after the plaintiff had proceeded with its case. In Indiana, want of jurisdiction can be waived by a party failing to make a timely and specific objection,⁸⁹ and *Western Parks* was an appropriate case to apply that reasoning. This proposition is indirectly supported by decisions such as *Jefferson Park Realty*, holding that corporations which have proceeded to trial without being represented by an attorney are bound by adverse judgments.⁹⁰

The court in *Western Parks* cited and relied on the Illinois decision in *Tom Edwards Chevrolet, Inc. v. Air-Cel, Inc.*⁹¹ In *Edwards*, the defendant Air-Cel filed a motion to allow the corporation to be represented by its president and minority shareholder, who was not a licensed attorney. The motion was denied and a default judgment entered. The judgment was affirmed on appeal with the court holding that Air-Cel had to be represented by an attorney.⁹² Just as Air-Cel was bound by its decision to proceed without an attorney, *Western Parks* should have been bound when it filed its motion to dismiss because it failed to object that the complaint was not filed by an attorney. In *Nicholson Supply Co. v. First Federal Savings &*

⁸⁷In this respect, the supreme court might be well advised to adopt a rule permitting corporations to appear by nonattorneys in small claims proceedings.

⁸⁸If *Western Parks*, a corporation, was not represented by an attorney at the outset, the claim for a waiver is even stronger.

⁸⁹IND. R. TR. P. 12(A). See *Pittsburgh C., C. & St. L. Ry. v. Gregg*, 181 Ind. 42, 102 N.E. 961 (1913).

⁹⁰105 Ind. App. 313, 322, 12 N.E.2d 977, 981 (1938). Other cases holding corporations represented by nonattorneys bound by adverse results are: *Jardine Estates, Inc. v. Koppel*, 24 N.J. 536, 133 A.2d 1 (1957); *Cohn v. Warschauer Sick Support Soc'y Bnei Israel*, 19 N.Y.S.2d 742 (Sup. Ct. 1940); *Phoenix Mut. Life Ins. Co. v. Radcliffe on the Delaware, Inc.*, 439 Pa. 159, 266 A.2d 698 (1970).

⁹¹13 Ill. App. 3d 378, 300 N.E.2d 312 (1973), cited in 383 N.E.2d at 292.

⁹²13 Ill. App. 3d at 378-79, 300 N.E.2d at 312-13.

Loan Association,⁹³ which the court also relied on, a complaint signed by the president of a corporation was stricken and held a nullity.⁹⁴ Consequently, the complaint could not have been amended after the time for foreclosing a lien had lapsed by substituting an attorney's signature for that of the president. Again, it is noteworthy that the objection was raised at the outset of the proceeding.

Western Parks is the only decision discovered that has permitted a party represented by an attorney to challenge a judgment for the first time after the judgment has been rendered because the prevailing corporation did not appear by an attorney. The closest decision is *City of Akron v. Hardgrove Enterprises*,⁹⁵ in which the trial court permitted a lay person to represent the defendant over the city's objection. Under these circumstances, it would be unfair to penalize the city for going ahead with the proceeding after the court allowed the lay representation. That reasoning is more understandable than permitting the losing party to raise the issue after judgment has been entered, even if judgment is by default.⁹⁶

Perhaps the Indiana Supreme Court felt that *Western Parks* might be the only opportunity to establish the proposition that corporations must be represented by attorneys, even in small claims proceedings. The case was not really a proper vehicle for that determination, however, and the court probably would have been better advised to have vacated the alternative writ of mandate and prohibition instead of making it permanent, because *Western Parks* had waived any objection to lay persons appearing and proceeding for Remove All.

C. Closely Held Corporations

The proposition that Indiana courts are willing to recognize the unique nature of the closely held corporation was strengthened by the decision in *Cressy v. Shannon Continental Corp.*⁹⁷ The *Cressy* court held that the lower court correctly invoked its equity power to

⁹³184 So. 2d 438 (Fla. Dist. Ct. App. 1976), cited in 383 N.E.2d at 292.

⁹⁴*Id.* at 442.

⁹⁵353 N.E.2d 628 (Ohio Ct. App. 1976).

⁹⁶See also *City of DeKalb v. Nehring Elec. Works, Inc.*, 40 Ill. App. 3d 726, 353 N.E.2d 150 (1976).

⁹⁷378 N.E.2d 941 (Ind. Ct. App. 1978). In *Motor Dispatch, Inc. v. Buggie*, 379 N.E.2d 543 (Ind. Ct. App. 1978), the court of appeals also recognized that a fiduciary in a closely held corporation must deal "fairly, honestly and openly with the corporation and his fellow shareholders and must not be distracted from the performance of official duties by personal interest." *Id.* at 547. In *Motor Dispatch*, however, there was no evidence that the defendant had done anything injurious to the financial interest of the corporation or that he had failed to deal with his fellow shareholders fairly, honestly, and openly.

accomplish the intent of the principal shareholders in organizing Shannon,⁹⁸ but the court reversed and remanded on the issue of the appropriate relief.⁹⁹

Cressy involved challenges to the validity of certain share transactions made by each of the principal shareholders of Shannon which altered control of the corporation. Cressy and Russell, the principal shareholders, had each subscribed to and received 425 of the 1,000 common shares authorized by the articles of incorporation. The dispute involved some of the remaining 150 authorized shares.

The affairs of the corporation did not prosper,¹⁰⁰ and the board of directors eventually adopted a resolution authorizing Russell to borrow money for the corporation and to sell additional authorized but unissued shares if the money could not be borrowed. Cressy testified that he knew shares could be sold, but that he did not know how many or when shares would be sold or that Russell contemplated selling thirty shares to his parents. The effect of this transaction was to give Russell ownership or control of 455 shares. Cressy challenged this transaction. Russell in turn challenged Cressy's purchase of seventy-five Shannon shares from Shannon's treasurer and accountant.¹⁰¹ Cressy had not notified Russell or the other shareholders of that purchase.

The litigation arose when Cressy was unable to transfer these shares into his name. He filed two suits: the first sought to compel the transfer of the shares to his name, and the second sought to set aside the sale of the thirty shares to Russell's parents. Russell counterclaimed, asserting that Cressy's shares were issued without consideration, that the treasurer's shares were issued without consideration, and that Cressy's purchase of those shares violated an agreement between the treasurer and Russell.

The trial court concluded that Cressy and Russell had intended to be "equal partners" when forming Shannon and that the court should invoke its equity jurisdiction to secure such an intent. Hence, the trial court entered an order amending Shannon's articles of incorporation to establish a second class of shares, which did not possess voting rights but which were identical to the shares described in the articles of incorporation in all other respects.¹⁰² The thirty shares owned by Russell's parents and the seventy-five shares

⁹⁸378 N.E.2d at 945.

⁹⁹*Id.*

¹⁰⁰The two principals made personal loans to Shannon to help it meet its financial obligations and with their wives, personally guaranteed a loan received by the corporation.

¹⁰¹The remaining shares had been issued to other individuals.

¹⁰²The decree declared the amendment and ordered the secretary of state to reflect it in his records. 378 N.E.2d at 944 n.5.

Cressy had acquired from the treasurer were then declared to be nonvoting shares of the second class. The end result was that Cressy and Russell were again in a position of equality with 425 voting shares each. Only Cressy appealed from the judgment.¹⁰³

Cressy first challenged the ability of the court to recognize an "incorporated partnership." The court of appeals rejected this contention,¹⁰⁴ relying on *Hartung v. Architects Hartung/Odle/Burke, Inc.*,¹⁰⁵ which recognized that shareholders of closely held corporations owe a fiduciary duty to each other to deal fairly, honestly, and openly when the parties plan to run the enterprise in a manner akin to a partnership rather than strictly adhering to the traditional corporate norm.¹⁰⁶

Thus, the *Cressy* court places Indiana among those jurisdictions which have concluded that the statutory norm imposed by a general corporation act is not inflexible and can be varied by the principals of the corporation. The court accepts the reality that, although persons incorporate to obtain the various benefits afforded by the corporate form of enterprise, "they often expect to act and to be treated as partners in their dealings among themselves."¹⁰⁷ The premise is simple—when the principals of a corporation do not intend to follow the corporate norm and no harm results to outsiders thereby, there is no reason to frustrate the parties' intent.¹⁰⁸ The

¹⁰³Pursuant to IND. R. TR. P. 52(D), the decision of the trial court was treated as made on a general finding because no special findings were requested. See *Arnette v. Helvie*, 148 Ind. App. 476, 267 N.E.2d 864 (1971). Consequently, the standard of review on factual issues was the standard applicable to jury verdicts: a judgment should be affirmed if it is correct on any theory of law applicable to the evidence. See *In re Estate of Fanning*, 263 Ind. 414, 333 N.E.2d 80 (1975); *Notter v. Beasley*, 240 Ind. 631, 166 N.E.2d 643 (1960).

¹⁰⁴378 N.E.2d at 945.

¹⁰⁵157 Ind. App. 546, 301 N.E.2d 240 (1973), discussed in Galanti, *Business Associations, 1974 Survey of Recent Developments in Indiana Law*, 8 IND. L. REV. 24, 42-46 (1974).

¹⁰⁶157 Ind. App. at 552, 301 N.E.2d at 243. The court concluded that the evidence sustained the finding that Cressy and Russell intended equal ownership and control of the business and that each had breached the concomitant duty of disclosing the availability of outstanding shares and giving the other the chance to participate in the purchase of the shares. 378 N.E.2d at 945. See generally Brudney, *Fiduciary Ideology in Transactions Affecting Corporate Control*, 65 MICH. L. REV. 259, 289-94 (1966).

¹⁰⁷378 N.E.2d at 945. The court correctly noted that not all corporations with few shareholders operate informally because the shareholders may well intend to operate the corporation strictly in accordance with the corporate norm to both the world-at-large and among themselves. *Id.* n.6. In other words, the court recognized that the intent of the parties was to control and that this intent would be recognized whether it was to follow or depart from the corporate norm.

¹⁰⁸See generally Conway, *The New York Fiduciary Concept in Incorporated Partnerships and Joint Ventures*, 30 FORDHAM L. REV. 297, 309-11 (1962); Hornstein, *Judicial Tolerance of the Incorporated Partnership*, 18 L. & CONTEMP. PROB. 435 (1952). Both articles were cited by the court. 378 N.E.2d at 945.

issue often arises in cases involving formal agreements restricting the discretion of the board of directors of a corporation.¹⁰⁹ There is no reason, however, for a written agreement to be required, and a court of equity should clearly have the authority to give effect to the intention of the parties even when it is not reflected in a written document.¹¹⁰

In addition to relying on *Hartung* in determining that Indiana recognizes the incorporated partnership, the *Cressy* court also cited the leading case of *Helms v. Duckworth*,¹¹¹ in which Judge Burger, now the Chief Justice of the United States Supreme Court, concluded that in intimate business ventures in which there is no division between the shareholder-owners and the director-managers of the corporation, the shareholders would bear the relation of trust and confidence to each other which prevails in partnerships.¹¹² The attitude taken by the *Cressy* court certainly cannot be faulted. Rather, it should be commended because it recognizes the considerable difference between the large publicly held corporation, for which the strictures of the corporation act are necessary to protect the interests of shareholders who are not actively involved in the running of the corporation, and the small corporation, in which the principals *in fact* operate the enterprise as if it were a partnership.

The only objection to *Cressy* is the court's statement that "the imposition of such duties as the term 'incorporated partnership' implies is a recognition that this form of business enterprise is a hybrid."¹¹³ Unfortunately, this statement can lead to the supposition that there is some intermediate form of enterprise between the partnership and the corporation. This supposition is not true. The corporation involved in *Cressy* was in fact a corporation—it was not a partnership. To maintain its status as a corporation, the corporation had to satisfy the requirements of the Indiana Act. Furthermore, if the parties had ignored corporate formalities and had treated the enterprise as a partnership, they could well have lost the right to limited liability if a court had decided to "pierce the corporate veil."¹¹⁴ A more accurate description of the status of Shannon

¹⁰⁹See, e.g., *Galler v. Galler*, 32 Ill. 2d 16, 203 N.E.2d 577 (1964). Compare *McQuade v. Stoneham*, 263 N.Y. 323, 189 N.E. 234 (1934), with *Clark v. Dodge*, 269 N.Y. 410, 199 N.E. 641 (1936).

¹¹⁰See, e.g., *Donahue v. Rodd Electrotpe Co.*, 367 Mass. 578, 328 N.E.2d 505 (1975). But see *Zidell v. Zidell, Inc.*, 277 Or. 423, 560 P.2d 1091 (1977).

¹¹¹249 F.2d 482 (D.C. Cir. 1957), cited in 378 N.E.2d at 945.

¹¹²249 F.2d at 486.

¹¹³378 N.E.2d at 945.

¹¹⁴*Cf. Edward Shoes, Inc. v. Orenstein*, 333 F. Supp. 39 (N.D. Ind. 1971) (defendant shareholder not liable for corporate debtor's liabilities incurred after the articles of incorporation revoked in the absence of allegations that the defendant acted knowingly, wilfully, or with the intent to defraud in incurring the liabilities on the corporation's

is that it was analogous to a partnership that had been incorporated. This would recognize the right of the parties to operate the enterprise to some extent as they saw fit while reemphasizing that it was in fact a corporation.

Furthermore, the unqualified use of the term "incorporated partnership" would seem to ignore the established principle that an action by the principals directly contravening a requirement of a corporation law is ineffective.¹¹⁵ Although this position can be criticized,¹¹⁶ it does recognize that in adopting a corporation act the legislature has spoken, and thus parties cannot ignore it entirely.¹¹⁷

Cressy acknowledges the overriding impact of the Indiana Act in holding that the trial court erred in amending Shannon's articles of incorporation to provide for a new class of nonvoting shares.¹¹⁸ The court noted that the only decisions discussing whether a court's equity powers could give it authority to order amendments to articles of incorporation have held that the courts do not have such authority.¹¹⁹ The court concluded that, unless a statute exists which specifically authorizes a court to order amendments, the procedure for amending articles as set forth in the Indiana Act¹²⁰ must be followed.¹²¹ Of course, the court was noting that the legislature had not granted the court authority to amend articles, but indirectly, the court was acknowledging the ultimate authority of the legislature to determine the manner in which corporations are operated.

Cressy's contention that the shares issued to Russell's parents should have been invalidated because the meeting at which the sale was authorized was improperly called and Cressy's additional contention that he had not been afforded his preemptive rights, were also rejected by the court.¹²² The court, in effect, treated the issue as one of waiver because Cressy was present at the meeting in which Russell was authorized to sell the shares and raised no objection.

behalf). For a general discussion of when the "corporate veil" will be pierced, see H. HENN, *supra* note 19, § 146-149; 1, 2 G. HORNSTEIN, *supra* note 19, §§ 31, at 751-59; Hamilton, *The Corporate Entity*, 49 TEX. L. REV. 979 (1971).

¹¹⁵*Somers v. AAA Temporary Servs., Inc.*, 5 Ill. App. 3d 931, 284 N.E.2d 462 (1972).

¹¹⁶See R. HAMILTON, CORPORATIONS 437-38 (1976).

¹¹⁷See generally Bradley, *Toward a More Perfect Close Corporation—The Need for More and Improved Legislation*, 54 GEO. L.J. 1145 (1966).

¹¹⁸378 N.E.2d at 946.

¹¹⁹*Id.* Disabled Am. Veterans v. Hendrixson, 9 Utah 2d 152, 340 P.2d 416 (1959); Casper v. Kalt-Zimmer Mfg. Co., 159 Wis. 517, 149 N.W. 754 (1914). See generally 7A W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 3716 (perm. ed. 1978).

¹²⁰IND. CODE §§ 23-1-4-1 to -7 (1976).

¹²¹378 N.E.2d at 946.

¹²²*Id.*

Hence, Cressy was precluded from asserting either a claim for preemptive rights to the shares or objecting to technical deficiency in the meeting.¹²³

The court observed that the trial court could have required Cressy and Russell "to exercise their voting rights consistent with their obligations"¹²⁴ or could have ordered the sale by the corporation of an equalizing number of shares, instead of exceeding its authority by attempting to amend the articles. Unfortunately, the latter remedy of a forced sale would have presented a problem, because at the time of the trial Shannon's 1,000 authorized shares had been issued and the only way additional shares could be issued would have been to amend the articles of incorporation. It would seem possible, however, that the court, by exercising its equity jurisdiction, could have ordered Cressy and Russell to take the steps necessary to amend Shannon's articles of incorporation to carry out their intended understanding themselves, doing indirectly what the court could not do directly.¹²⁵

D. Merger of Not-For-Profit Corporations

An interesting but questionable case involving the merger procedures for not-for-profit corporations was decided during the survey period. In *Knightstown Lake Property Owners Association v. Big Blue River Conservancy District*,¹²⁶ the court of appeals affirmed a decision in a condemnation proceeding holding that Pioneer Village Lot Owners Association, an Indiana not-for-profit corporation, had no interest in land being condemned by the Big Blue River Conservancy District.¹²⁷

In 1924 the property in question was conveyed to the Knightstown Lake Property Owners Association, also a not-for-profit corporation.¹²⁸ All the owners of lots in the Knightstown Lake subdivision were members of Knightstown Lake. Knightstown Lake apparently maintained its corporate existence from 1924 until 1932,

¹²³See *Jones v. Milton & Rushville Turnpike Co.*, 7 Ind. 547 (1856); 18 AM. JUR. 2d *Corporations* § 251 (1965). The court did not decide whether denying voting rights to Russell's parents was improper because they had not assigned any errors.

¹²⁴378 N.E.2d at 946.

¹²⁵See *Weil v. Beresth*, 154 Conn. 12, 220 A.2d 456 (1966).

¹²⁶383 N.E.2d 361 (Ind. Ct. App. 1978). For another discussion of this case, see Falender, *Property, 1979 Survey of Recent Developments in Indiana Law*, 13 IND. L. REV. 343, 351-54 (1980).

¹²⁷383 N.E.2d at 367. The property in question consisted of public spaces conveyed to a property owners association with the expectation that the property would be conveyed to a municipal corporation if the subdivision ever became a municipality. This condition had not occurred.

¹²⁸Knightstown Lake presumably was incorporated under the Indiana Voluntary Association Act of 1901, ch. 127, 1901 Ind. Acts 289 (repealed 1929).

but there was no evidence that it acted in any corporate capacity, other than to pay taxes on the property, from 1932 until 1965. Pioneer was organized in 1965, and paid the taxes on the property thereafter. The trial court rejected Pioneer's contention that it owned the property and held that the property, which had been originally conveyed to Knightstown Lake, passed to the lot owners who were the ultimate beneficiaries of the conveyance when the association ceased to exist. The court of appeals affirmed.¹²⁹ Starting with the premise that an appellate court will not weigh conflicting evidence,¹³⁰ the court concluded that Pioneer had not sustained the burden of asserting title to or showing an equitable interest in the property.¹³¹ Consequently, Pioneer had no interest in the property other than reimbursement for the taxes it had paid.

Pioneer contended that it was a successor to Knightstown Lake on the basis of either a 1976 statutory merger or a 1965 de facto merger that occurred when Pioneer was organized and undertook to pay the taxes. The *Knightstown* court rejected the first argument, holding that the right to and procedures for merging not-for-profit corporations were governed by statute and that there was no evidence the two organizations had complied with the statutory requirements.¹³² There was no proof that the persons acting as officers of Knightstown Lake, who purportedly carried out the merger, had been duly elected; no annual reports had been filed with the secretary of state with the exception of a "composite" report for activities from 1971 to 1975. In fact, it would appear that Knightstown Lake had ceased to exist for failing to file annual reports long before 1976.¹³³ Thus, even if the original members of Knightstown Lake or their successors had attempted to elect officers and effectuate a merger, the entity itself no longer existed.

The court of appeals also rejected the contention that there had been a de facto merger of Knightstown Lake and Pioneer in 1965 because the organizations had failed to demonstrate compliance with the statute.¹³⁴ Unfortunately, this seems to be a misunderstanding of the de facto merger doctrine. The usual de facto merger involves a

¹²⁹383 N.E.2d at 368.

¹³⁰*Id.* at 365. See *State ex rel. Roberts v. Graham*, 231 Ind. 680, 110 N.E.2d 855 (1953).

¹³¹383 N.E.2d at 366-67. See *Aircraft Acceptance Corp. v. Jolly*, 141 Ind. App. 515, 518, 230 N.E.2d 446, 449 (1967) (citing 73 C.J.S. *Property* § 17 (1951)).

¹³²383 N.E.2d at 366-67. See generally H. HENN, *supra* note 19, § 346; 1 G. HORNSTEIN, *supra* note 19, § 362, at 470-71.

¹³³Knightstown Lake had been obligated to file annual reports since 1949, and failure to do so was grounds for forfeiture of its articles. See IND. CODE §§ 23-3-6-1 to -3 (1976).

¹³⁴383 N.E.2d at 366-67.

corporate reorganization not originally structured as a merger, which a court determines to be a merger *in fact* for purposes of the right of shareholders to dissent and receive the appraised value of their shares.¹³⁵ Application of the doctrine is also appropriate when there has been a good faith attempt to follow the statutory merger procedures which falls short of the requirements.¹³⁶ It is at least arguable that the *Knightstown* court could have found that Pioneer was the legal successor to Knightstown Lake. Apparently, in 1965 persons directly interested in the subdivision had attempted to form a successor organization to Knightstown Lake to control the public spaces of the subdivision. Although the effort was not as thorough as required, it would appear that the attempt was close enough to have justified the court holding in favor of Pioneer.

Certainly, Pioneer had the burden of proving title, but by holding that Pioneer failed to sustain the burden, the court produced the anomalous result that the organization created by the landowners to take control of the common spaces in the subdivision had no title or interest in the property. The unfortunate consequence of this conclusion is that Pioneer was entitled to be reimbursed by its own members for the taxes it had paid. The members were entitled to receive the proceeds of the condemnation proceeding, but the court did not indicate how the proceeds should be divided. As a purely practical matter, a decision in favor of Pioneer would have expedited the distribution of the award.

E. Agent's Liability

The result in *Brown v. Owen Litho Service, Inc.*¹³⁷ vividly illustrates the consequences of an agent's carelessness in conducting business on behalf of his principal and indirectly describes the consequences of careless operation of a corporate enterprise. In *Brown*, the court of appeals affirmed a judgment that Brown, as an individual, was liable for what he claimed to be the debts of J.J. Brown Publishing, Inc.¹³⁸ The dispute was over payment of Owen

¹³⁵See, e.g., *Farris v. Glen Alden Corp.*, 393 Pa. 427, 143 A.2d 25 (1958). See generally H. HENN, *supra* note 19, § 349, at 725-26.

¹³⁶See *John Mohr & Sons v. Apex Terminal Warehouses, Inc.*, 422 F.2d 638 (7th Cir. 1970); *Smith v. Cleveland, C., C. & St. L. Ry.*, 170 Ind. 382, 81 N.E. 501 (1907). See generally 15 W. FLETCHER, *supra* note 119, §§ 7152-7155. This aspect of the de facto merger doctrine is similar to the de facto corporation doctrine, which arises when an attempt to organize a corporation falls short of the procedures mandated by the applicable corporation act, but is substantial enough to justify the conclusion that a corporation exists for all purposes except when challenged by the state. See generally H. HENN, *supra* note 19, § 140; 1 G. HORNSTEIN, *supra* note 19, §§ 27-30.

¹³⁷384 N.E.2d 1132 (Ind. Ct. App. 1979).

¹³⁸*Id.* at 1136. The actual nature of the corporation is unclear. The court mentioned that the corporation was "apparently" organized as a not-for-profit corporation, *id.* at

Litho's charges for printing a magazine published by Brown. Brown contended that he incurred the debts while acting as an officer and agent of the corporation and therefore should be absolved from personal liability.¹³⁹

An established principle of agency law is that an agent normally is not liable for the debts of his principal.¹⁴⁰ The issue before the court, however, was whether Brown had met the burden of establishing that he had disclosed the agency relationship and the existence and identity of the principal to Owen Litho.¹⁴¹ The court of appeals concluded that Brown had not sustained his burden despite his contention, contrary to the testimony of an Owen Litho sales representative, that he had made full disclosure before the printing agreement was reached.¹⁴² Brown realized that the trial court was free to disbelieve his testimony,¹⁴³ and so he attempted to rely on three pieces of documentary evidence to establish disclosure as a matter of law.

The first two documents were checks which were imprinted with the name of the corporation and were drawn on its account. The checks were signed by Brown and another officer of the corporation. The court discounted this evidence because the face of the checks did not indicate the capacity in which the signators signed. Arguably, the court was wrong on this point because the important factor under agency law is whether the persons were *authorized* to sign the checks.¹⁴⁴ Indication of the signators' capacities on the check is of little significance as proof of a disclosed principal.¹⁴⁵ However, the conclusion in this instance that the checks did not give notice to Owen Litho of the agency relationship appears well founded. The issue in *Brown* was Owen Litho's awareness of the relationship at the time of the transaction. The court followed the general and preferred view that disclosure of the previously undisclosed principal after the contract has been executed has no bearing on the relationship created between the agent and the third party at the

1134, but because it appears to have been intended as a profit-making venture, organization under the Indiana Not-For-Profit Corporation Act would not have been appropriate. *See* IND. CODE § 23-7-1.1-2(d) (1976).

¹³⁹384 N.E.2d at 1133. The opinion does not indicate whether the corporation itself was held liable. Presumably, it was but the corporation probably had no assets.

¹⁴⁰RESTATEMENT (SECOND) OF AGENCY §§ 320-322 (1957).

¹⁴¹384 N.E.2d at 1133-34. *See* *Vawter v. Baker*, 23 Ind. 63 (1864). *See also* RESTATEMENT (SECOND) OF AGENCY § 320, Comment b (1957).

¹⁴²384 N.E.2d at 1136.

¹⁴³*Id.* at 1134. *See* *Neel v. Cass County Fair Ass'n*, 143 Ind. App. 339, 240 N.E.2d 546 (1968).

¹⁴⁴RESTATEMENT (SECOND) OF AGENCY § 76 (1957).

¹⁴⁵*Id.* §§ 26-27. The failure to designate the representative capacity can be significant, however, under the Uniform Commercial Code. *See* IND. CODE § 26-1-3-403 (1976).

time of the transaction; thus, the subsequent disclosure will not relieve the agent from personal liability on the contract.¹⁴⁶

The *Brown* court was particularly persuaded by decisions from other jurisdictions holding that the existence of checks drawn on a corporate account, standing alone, is insufficient to disclose an agency relationship and the existence and identity of the principal.¹⁴⁷ The court did acknowledge *Potter v. Chaney*,¹⁴⁸ however, in which it was held that the defendant had fully revealed his agency because the corporate principal had existed at the time of the transactions and the checks paying for goods were always signed by the defendant as president of the corporation and were drawn on the corporate account.¹⁴⁹ The *Potter* transactions, however, occurred over a period of four years as contrasted with a period of less than six months in *Brown*. A court could rightly conclude that when a third party receives and negotiates checks drawn on a corporate account over a long period of time, he can be presumed to know of the corporation's existence and to know that he is in fact dealing with a corporation. This is not necessarily true when the period of time is short, as in *Brown*.¹⁵⁰

The third piece of documentary evidence relied on by *Brown* was a letter, signed in the name of the president and general manager of Owen Litho, that was addressed to the corporation. This letter was discounted because it was the only letter addressed to the corporation. The balance of Owen Litho's correspondence was addressed to *Brown* or to the magazine. Furthermore, although the letter bore the signature of the president and general manager, his secretary, who was authorized to write and sign such routine letters, had in fact signed it.¹⁵¹ The court of appeals concluded that the three documents could not support the inference that as a matter of

¹⁴⁶384 N.E.2d at 1135. The court cited and relied on *Myers-Leiber Sign Co. v. Wierich*, 2 Ariz. App. 534, 410 P.2d 491 (1966); *Olympic Elec. Serv., Inc. v. Craig*, 286 So. 2d 182 (La. Ct. of App. 1973); *Carter v. Walton*, 469 S.W.2d 462 (Tex. Ct. App. 1971).

¹⁴⁷384 N.E.2d at 1135-36 (citing *Diamond Match Co. v. Crute*, 145 Conn. 277, 141 A.2d 247 (1958); *Olympic Elec. Serv., Inc. v. Craig*, 286 So. 2d 182 (La. Ct. of App. 1973); *Darr v. Kinchen*, 176 So. 2d 638 (La. Ct. of App.), *cert. denied*, 248 La. 386, 178 So. 2d 664 (1965); *Giglio v. Lunsford*, 165 So. 2d 60 (La. Ct. of App. 1964); *Wilson v. McNabb*, 157 So. 2d 897 (La. Ct. of App. 1963)).

¹⁴⁸290 S.W.2d 44 (Ky. 1956), *noted in* 384 N.E.2d at 1136 n.5.

¹⁴⁹290 S.W.2d at 46.

¹⁵⁰The transactions in *Potter* "were on a day-by-day basis." *Id.* at 46. The problem, of course, is to draw the line between a few transactions in a short time period and many transactions over an extended time period.

¹⁵¹For a discussion of when notice to and knowledge of an agent will be imputed to the principal, see W. SEAVEY, AGENCY §§ 96-102 (1964); W. SELL, AGENCY §§ 86, 88-92 (1975).

law Owen Litho knew, or a reasonable person would have known, that Brown was acting as an agent for the corporation.¹⁵²

The lesson of *Brown* is painfully clear. A person acting for a principal, whether an individual or a corporation, who fails to disclose the capacity in which he acts and the existence and identity of the principal acts at his peril.¹⁵³ Although an undisclosed principal is liable for obligations incurred on his behalf by the agent,¹⁵⁴ the agent is jointly liable with the principal and the third party may choose which party to pursue for the obligation.¹⁵⁵

As the court noted, to avoid personal liability, an agent is obligated to disclose the existence and identity of the principal.¹⁵⁶ The agent will not be relieved of this duty even when the third person had knowledge of facts and circumstances which, if pursued, would have disclosed the existence and identity of the principal.¹⁵⁷ The general rule is that an agent of a partially disclosed principal is bound on a contract,¹⁵⁸ and the agent is presumed to be a party in the absence of evidence otherwise.¹⁵⁹ In effect, the agent is obliged to give the third person actual knowledge of the existence and identity of the principal or provide that knowledge which to a reasonable person is equivalent to actual knowledge.¹⁶⁰ The nature of the relationship between the principal and the third party—fully disclosed, partially disclosed, or undisclosed—depends on the agent's representations and the third party's knowledge at the time of the transaction. These are factual issues to be determined by the circumstances surrounding the transaction.¹⁶¹

¹⁵²384 N.E.2d at 1136.

¹⁵³See *Polk v. Haworth*, 48 Ind. App. 32, 95 N.E. 332 (1911).

¹⁵⁴*Watteau v. Fenwick*, [1893] 1 Q.B. 346. See generally RESTATEMENT (SECOND) OF AGENCY § 186 (1957).

¹⁵⁵RESTATEMENT (SECOND) OF AGENCY § 337 (1957). Furthermore, even if Brown had disclosed the principal, the court correctly noted that he would be relieved of liability only for transactions subsequent to the disclosure. 384 N.E.2d at 1135. See *Revere Press, Inc. v. Blumberg*, 431 Pa. 370, 246 A.2d 407 (1968).

¹⁵⁶384 N.E.2d at 1135 (citing *Polk v. Haworth*, 48 Ind. App. 32, 95 N.E. 332 (1911)).

¹⁵⁷See *Orient Mid-East Lines v. Albert E. Bowen, Inc.*, 458 F.2d 572 (2d Cir. 1972) (construing New York law); *Vander Wagen Bros., Inc. v. Barnes*, 15 Ill. App. 3d 550, 304 N.E.2d 663 (1973); *Mawer-Gulden Annis, Inc. v. Brazilian & Columbian Coffee Co.*, 49 Ill. App. 2d 400, 199 N.E.2d 222 (1964).

¹⁵⁸See, e.g., *Hagen v. Brozozowski*, 336 S.W.2d 213 (Tex. Ct. App. 1960). See generally *W. SEAVEY*, *supra* note 151, § 123, at 211-12; RESTATEMENT (SECOND) OF AGENCY § 321 (1957).

¹⁵⁹See authorities cited in *W. SEAVEY*, *supra* note 151, § 70E, at 123 n.2.

¹⁶⁰See *Howell v. Smith*, 261 N.C. 256, 260, 134 S.E.2d 381, 384 (1964).

¹⁶¹See *Chambliss v. Hall*, 113 Ga. App. 96, 147 S.E.2d 334, 338 (1966); *Matsko v. Dally*, 49 Wash. 2d 370, 301 P.2d 1074, 1077 (1956). See also 3A *W. FLETCHER*, *supra* note 119, § 1133.

The *Brown* result is clearly correct. It might seem harsh because Brown probably believed, in good faith, that he was acting on behalf of and as an agent of the corporation. A person in Brown's position of "owning" the corporation might understandably refer to it as "his" business and not as a separate corporate entity. The court appropriately held Brown liable for the corporation's obligations, however, because he had failed to inform third persons that any obligations incurred were those of the corporation. In general, a third party is justified in holding an agent liable on a contract when that party thinks the agent is the only party to be bound, even if an undisclosed principal is also liable. Also, it would not have been appropriate to have held Owen Litho to the general standard that a third party, aware that a contract is to be made on behalf of a known principal, is obligated to determine the credit worthiness of the principal or suffer the consequences. Owen Litho was not aware that anyone but Brown was involved, and thus could not have been held responsible for determining the credit worthiness of a corporation which it did not know existed and which might not have been acceptable as a creditor if known.

F. Statutory Developments¹⁶²

1. *Business Takeover Act.*—The most significant legislative development during the survey period was Public Law 235, enacting a new Indiana Business Takeover Act¹⁶³ and repealing the old takeover act.¹⁶⁴ The new Act clearly was passed in response to the Fifth Circuit Court of Appeals decision in *Great Western United Corp. v. Kidwell*,¹⁶⁵ affirming a lower court decision¹⁶⁶ declaring the Idaho Business Takeover Act unconstitutional¹⁶⁷ because it was preempted by the Williams Act amendments to the 1934 Act¹⁶⁸ and was an impermissible burden on interstate commerce in violation of

¹⁶²The author wishes to express his appreciation to Christine Ratliff Lundquist for her assistance in preparing this section of the Survey.

¹⁶³Act of Apr. 6, 1979, Pub. L. No. 235, § 1, 1979 Ind. Acts 1122 (codified at IND. CODE §§ 23-2-3.1-1 to -11 (Supp. 1979)) [hereinafter referred to as the new Act].

¹⁶⁴Act of Apr. 6, 1979, Pub. L. No. 235, § 2, 1979 Ind. Acts 1129 (repealing IND. CODE §§ 23-2-3-1 to -12 (1976)) [hereinafter referred to as the old Act]. The old Act was discussed in Galanti, *Business Associations, 1975 Survey of Recent Developments in Indiana Law*, 9 IND. L. REV. 33, 53-59 (1975) [hereinafter cited as *1975 Survey*], and Note, *The Indiana Business Takeover Act*, 51 IND. L.J. 1051 (1976).

¹⁶⁵577 F.2d 1256 (5th Cir. 1978), *rev'd on other ground sub nom.* Leroy v. Great W. United Corp., 47 U.S.L.W. 4844 (U.S. June 26, 1979).

¹⁶⁶*Great W. United Corp. v. Kidwell*, 439 F. Supp. 420 (N.D. Tex. 1978), *rev'd on other grounds, sub nom.* Leroy v. Great W. United Corp., 47 U.S.L.W. 4844 (U.S. June 26, 1979).

¹⁶⁷577 F.2d at 1286. The Idaho Business Takeover Act was codified at IDAHO CODE §§ 30-1501 to -1513 (Supp. 1977).

¹⁶⁸577 F.2d at 1281. See 15 U.S.C. §§ 78m(d)-(e), 78h(d)-(f) (1976).

the commerce clause.¹⁶⁹ Unfortunately, the *Great Western* litigation ended not with a bang but with a whimper. The Supreme Court, instead of deciding the case on the merits which would have resolved the status of the many state takeover statutes, reversed the Fifth Circuit on procedural grounds,¹⁷⁰ holding that venue to challenge the Idaho statute in the Northern District of Texas was improper.¹⁷¹ Justice Stevens, writing for the majority, concluded that section 28(a) of the 1934 Act¹⁷² did not impose a duty on Idaho securities officials, and consequently venue in the Texas court would not lie under section 27.¹⁷³ Although the interests of defendants must be considered in venue cases, the unfortunate consequence of the Court's decision is that a tender offeror wishing to challenge the constitutionality of a state takeover statute must do so within that state. As Justice White pointed out in his dissent, offerors might forego making tender offers rather than undertaking to attack a takeover act or defend an enforcement action in each state claiming jurisdiction.¹⁷⁴ The sheer logistics of attacking statutes in different states might be enough to discourage tender offers which, unfortunately, is often the main purpose of state takeover laws.

The old Act undoubtedly would have been invalid if *Great Western* had been affirmed. If the Supreme Court had reversed on the merits, the old Act might have passed constitutional muster, but this is now of academic interest only. The constitutionality of the new Act, however, has been upheld¹⁷⁵ without an in-depth discussion of the substantive issues raised in *Great Western*.¹⁷⁶

¹⁶⁹577 F.2d at 1286. See U.S. CONST. art. I, § 8, cl. 3. *Great Western* is not the only case challenging the constitutionality of business takeover acts. In *Uarco Inc. v. Daylin, Inc.*, No. 78-C-4246 (N.D. Ill., filed Oct. 30, 1978), the court preliminarily enjoined the Illinois Secretary of State from enforcing the Illinois Business Takeover Act (codified at ILL. ANN. STAT. ch. 121 1/2, §§ 137.51-70 (Smith-Hurd Supp. 1979)). The Illinois Act was also enjoined in *Mite Corp. v. Dixon*, No. 79-C-200 (N.D. Ill., filed Jan. 19, 1979).

In *Dart Indus. Inc. v. Conrad*, 462 F. Supp. 1 (S.D. Ind. 1978), the court entered a temporary restraining order enjoining enforcement of the old Act and the Delaware Tender Offers Act, DEL. CODE tit. 8, § 203 (1976). Subsequently, the Indiana Securities Commissioner issued an order exempting Dart's tender offer for the shares of P.R. Mallory & Company from the old Act, and the Indiana officials were dismissed from the case. The court thereafter held that the Delaware Act was preempted by the Williams Act and was invalid under the commerce clause, and the court granted permanent injunctive relief. 462 F. Supp. at 14-15. Also, a challenge to a takeover statute was declared moot when the offeror decided not to proceed in *Tyco Labs., Inc. v. Connelly*, [1979] FED. SEC. L. REP. (CCH) ¶ 96,933 (D. Mass.).

¹⁷⁰*Leroy v. Great W. United Corp.*, 47 U.S.L.W. 4844 (U.S. June 26, 1979).

¹⁷¹*Id.* at 4846-47.

¹⁷²15 U.S.C. § 78bb(a) (1976).

¹⁷³47 U.S.L.W. at 4847. See 15 U.S.C. § 78aa (1976).

¹⁷⁴47 U.S.L.W. at 4848 (White, J., dissenting).

¹⁷⁵*City Investing Co. v. Simcox*, No. 1P-79-462-C (S.D. Ind., filed July 27, 1979).

¹⁷⁶See notes 223-46 *infra* and accompanying text.

The definition section of the new Act,¹⁷⁷ like the definition section of the old Act,¹⁷⁸ is jurisdictional in nature because it determines which tender offers are covered. Several definitions in the two acts remain the same,¹⁷⁹ whereas others, though worded differently, are identical in substance and form.¹⁸⁰ The definition of "equity security," revised but still broadly defined, includes stock or similar securities possessing the right to vote on corporate matters at the time of the offer; securities convertible into such voting securities; warrants or rights to purchase such securities, as well as any other security denominated by regulations of the securities commissioner as necessary for investor protection.¹⁸¹ Thus, the new Act is not limited to corporate common shares but includes all securities that can influence control of the business enterprise.

A major change was made to the definition of "takeover offer." The new Act still defines takeover as "an offer to acquire or an acquisition of any equity security of a target company, pursuant to a tender offer or request or invitation for tenders, if, after the acquisition, the offeror is directly or indirectly a record or beneficial owner of more than ten percent . . . of any class of the outstanding equity securities of the target company."¹⁸² Certain transactions are excluded from the definition of a takeover, however, such as ordinary brokerage transactions, diminimus offers or acquisitions not exceeding two percent of the class within the preceding twelve months, or transactions determined by a ruling of the securities commissioner to be takeover offers not having or intended to have the effect of changing or influencing the control of the target corporation.¹⁸³

¹⁷⁷IND. CODE § 23-2-3.1-1 (Supp. 1979).

¹⁷⁸*Id.* § 23-2-3-1 (1976) (repealed 1979).

¹⁷⁹*Compare id.* § 23-2-3-1(f) (1976) (repealed 1979), *with id.* § 23-2-3.1-1(f) (Supp. 1979) (offeror). *Compare id.* § 23-2-3-1(g) (1976) (repealed 1979), *with id.* § 23-2-3.1-1(g) (Supp. 1979) (offeree). *Compare id.* § 23-2-3-1(h) (1976) (repealed 1979), *with id.* § 23-2-3.1-1(h) (Supp. 1979) (person).

¹⁸⁰*Compare id.* § 23-2-3-1(d) (1976) (repealed 1979), *with id.* § 23-2-3.1-1(d) (Supp. 1979) (control).

¹⁸¹*Compare id.* § 23-2-3-1(e) (1976) (repealed 1979), *with id.* § 23-2-3.1-1(e) (Supp. 1979).

¹⁸²*Id.* § 23-2-3.1-1(i) (Supp. 1979). Neither the 1934 Act nor the Williams Act amendments define the term tender or takeover offer, but the meaning of the term has become established to some extent under federal law. *See generally* Note, *The Developing Meaning of "Tender Offer" Under the Securities Exchange Act of 1934*, 86 HARV. L. REV. 1250 (1973). In February 1979, the SEC reaffirmed its position that because of the dynamic nature of tender offers, "a definition of the term 'tender offer' is neither appropriate or [sic] necessary." [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 81,935. The SEC, however, recently asked its staff to draft a rule to settle the issue of what constitutes a tender offer. *See* The Wall Street Journal, July 18, 1979, at 5, col. 1.

¹⁸³IND. CODE § 23-2-3.1-1(i)(1)-(2), (4) (Supp. 1979).

The new Act, as in the old Act, also excludes offers by the target company to purchase its own equity securities.¹⁸⁴ This exemption can be criticized because of the relatively recent phenomenon of publicly held corporations "going private" a few years after going public by buying the shares in the hands of a presumably unhappy public.¹⁸⁵ These shareholders are entitled to protection, and the takeover statute should be extended to include them. The exclusion does permit a tender for securities to increase a supply of treasury shares for corporate purposes, but if this were the sole purpose of the exclusion, it should have been drawn more narrowly. Also, in purchasing its own shares the corporation might be required to have an "agent," as defined under the Indiana Securities Act,¹⁸⁶ carry out the acquisition, with such a transaction subject to the antifraud¹⁸⁷ and criminal and civil penalty provisions of that act.¹⁸⁸ For this type of transaction, however, no information has to be disclosed—a critical omission if the new Act is designed to protect the investor and not corporate management, which usually benefits from a "going private" transaction.

Under the old Act, any company with less than fifty owners of record at the time of a takeover offer was excluded from the definition of a takeover.¹⁸⁹ Under the new Act, the same result is achieved by excluding "an issuer which does not have a class of equity securities held of record by fifty . . . or more persons as of the time of the offer"¹⁹⁰ from the definition of a target company.

One major difference in the new Act is that tender offers initiated or approved by the board of directors of the target company are no longer excluded as they were under the old Act.¹⁹¹ Thus, the so called "friendly" tender offer is now subject to regulation. This is a decided improvement, limiting management from "selling out" the shareholders.¹⁹²

¹⁸⁴Compare *id.* § 23-2-3-1(i)(4) (1976) (repealed 1979), with *id.* § 23-2-3.1-1(i)(3) (Supp. 1979).

¹⁸⁵See generally *1975 Survey, supra* note 164, at 55 n.101. The SEC recently adopted rules relating to "going private" transactions which prohibit fraudulent acts. [1979 Transfer Binder] FED. SEC. L. REP. ¶¶ 82,166-67.

¹⁸⁶IND. CODE § 23-2-1-1(b) (Supp. 1979).

¹⁸⁷*Id.* § 23-2-1-12 (1976).

¹⁸⁸*Id.* §§ 23-2-1-18.1 to -19 (1976 & Supp. 1979). A shareholder derivative suit might afford some protection if there is abuse. See *Perlman v. Feldman*, 219 F.2d 173 (2d Cir.), *cert. denied*, 349 U.S. 952 (1955). Procedural hurdles, however, decrease the effectiveness of such a remedy. See generally H. HENN, *supra* note 19, §§ 358-359; 2 G. HORNSTEIN, *supra* note 19, § 734.

¹⁸⁹IND. CODE § 23-2-3-1(i)(2) (1976) (repealed 1979).

¹⁹⁰*Id.* § 23-2-3.1-1(j)(5) (Supp. 1979).

¹⁹¹See *id.* § 23-2-3-1(i)(5) (1976) (repealed 1979).

¹⁹²One section of the new Act may cause a problem in this respect because it authorizes the securities commissioner to exempt "a takeover offer that is not made

Perhaps the most significant change in the definition section of the new Act is in the definition of "target company." The old Act defined a target company as "a corporation or other issuer of securities which is either organized under the laws of this state *or* has its principal place of business *or* a substantial portion of its total assets in this state."¹⁹³ The new Act, however, defines "target company" as "an issuer of securities which is organized under the laws of this state, has its principal place of business in this state, *and* has substantial assets in this state."¹⁹⁴ In other words, the old Act applied if any one of the three elements—incorporation, principal place of business, or substantial portion of assets—was satisfied, but the legislature drastically narrowed the scope of the new Act by requiring all three elements to coalesce. Whether this narrowing will protect the new Act from constitutional challenge remains to be seen.¹⁹⁵

The definition of target company under the old Act was so broad and had such extraterritorial scope that, theoretically, Indiana could have applied the term to a Saudi Arabian making a tender offer for English-owned shares of General Motors Corporation because of the extent of General Motors' Indiana assets. Of course, the old Act used the phrase "substantial assets," and the securities commissioner could have determined that the assets of General Motors in Indiana, though substantial in absolute terms, were not substantial relative to the worldwide assets of General Motors; thus, such a tender offer would have been exempt.¹⁹⁶

Also, a target company was defined under the old Act as "a corporation or other issuer of securities,"¹⁹⁷ whereas under the new Act it is defined as "an issuer of securities."¹⁹⁸ Although the language has been changed, it still appears that noncorporate business enterprises are subject to the new Act.

Finally, the old Act excluded target companies such as insurance companies, financial institutions, or public utilities for which a takeover offer was subject to approval by a state or federal

for the purpose of, and not having the effect of, changing or influencing the control of a target company." *Id.* § 23-2-3.1-1(2)(4) (Supp. 1979). The commissioner thus has considerable discretion to exempt friendly tender offers, and if a target's board of directors approved an offer, the commissioner might be favorably disposed to exempt the offer as not "changing or influencing the control" of the target company.

¹⁹³*Id.* § 23-2-3-1(j) (1976) (repealed 1979) (emphasis added).

¹⁹⁴*Id.* § 23-2-3.1-1(j) (Supp. 1979) (emphasis added).

¹⁹⁵See notes 223-46 *infra* and accompanying text.

¹⁹⁶Apparently, this was done in several tender offer filings under the old Act. See *Dart Indus. Inc. v. Conrad*, 462 F. Supp. at 7 (S.D. Ind. 1978).

¹⁹⁷IND. CODE § 23-2-3-1(j) (1976) (repealed 1979).

¹⁹⁸*Id.* § 23-2-3.1-1(j) (Supp. 1979).

regulatory agency.¹⁹⁹ This feature has been carried over to the new Act.²⁰⁰

The key substantive provisions of the old Act have not been changed. A takeover, as defined under either Act, is permitted only if the offer has become effective or is exempted by regulation or order of the securities commissioner.²⁰¹ The new Act provides that prior to a tender offer, the offeror must file a disclosure statement with the Indiana securities commissioner and deliver a copy of the statement to the president of the target company at its principal office by the same date.²⁰²

Perhaps the most significant difference between the new Act and the old Act is in the nature of the disclosure statement. The disclosure statement under the old Act was similar to the Indiana Securities Act registration statement,²⁰³ including offerors subject to the filing requirements of the Williams Act.²⁰⁴ Under the new Act, in a clear effort to avoid the Williams Act preemption ground found offensive in *Great Western*, the detailed disclosure statement must be filed only when the takeover is not subject to any requirement of federal law.²⁰⁵ If a tender offer is subject to the Williams Act or any other federal law, one copy of each document filed with the SEC or any other federal agency will satisfy the requirement.²⁰⁶ The requirement that the material terms of the proposed offer be publicly disclosed when the disclosure statement is filed has been eliminated.²⁰⁷

The new Act provides that "[a] takeover offer may be made . . . fifteen . . . business days after the date of filing the statement or such shorter time as the commissioner orders."²⁰⁸ Shares may not be purchased or paid for within the first fifteen business days after the

¹⁹⁹*Id.* § 23-2-3-12 (1976) (repealed 1979). See generally Galanti, *Business Associations, 1976 Survey of Recent Developments in Indiana Law*, 10 IND. L. REV. 57, 86 (1976).

²⁰⁰IND. CODE §§ 23-2-3.1-1(j)(1)-(4) (Supp. 1979).

²⁰¹*Compare id.* § 23-2-3-2(a) (1976) (repealed 1979), with *id.* § 23-2-3.1-2 (Supp. 1979). The offeror still must file a consent to service of process and pay a filing fee of \$750. *Compare id.* § 23-2-3-2(c), -7 (1976) (repealed 1979), with *id.* § 23-2-3.1-4 (Supp. 1979). An Indiana attorney need no longer file the statement. See *id.* § 23-2-3-2(b) (1976) (repealed 1979).

²⁰²*Id.* § 23-2-3.1-3 (Supp. 1979).

²⁰³*Compare id.* § 23-2-1-5 (1976) (Securities Act), with *id.* §§ 23-2-3-2(b)-(c) (1976) (repealed 1979) (old Act).

²⁰⁴15 U.S.C. §§ 78m(b)-(c), 78n(d)-(f) (1976).

²⁰⁵IND. CODE § 23-2-3.1-5 (Supp. 1979).

²⁰⁶*Id.*

²⁰⁷*Id.* § 23-2-3-2(b) (1976) (repealed 1979). This requirement prevented persons with advance knowledge of the takeover from taking advantage of it on the securities market.

²⁰⁸*Id.* § 23-2-3.1-6 (Supp. 1979).

offer, or in violation of any order of the securities commissioner.²⁰⁹ Thus, there is a minimum of thirty days between the time when the corporate management of the target company becomes aware of a potential tender offer and the time when the shares can be purchased. This obviously favors the target management because it eliminates the quick tender offer known as the "Saturday night special," and gives the target management an opportunity to defend a takeover.²¹⁰

The new Act still has a pro-management title, but it is an improvement over the old Act. The old Act provided that a takeover could not become effective until twenty days after the filing of the disclosure statement or any amendment thereto, except by order of the commissioner.²¹¹ It further provided that the effectiveness of an offer could be delayed if the commissioner ordered, or the target company requested, a hearing to determine whether the proposed tender offer was fair and equitable to the security holders.²¹² By carefully planned stalling tactics, the target corporation's management could delay an offer for up to 100 days, not including the additional time available to appeal an unfavorable order by the commissioner.²¹³ This potential for delay could have given management an opportunity to better the terms of the offer, benefiting the shareholders, but it also could have been used to thwart an offer which may have benefited the shareholders.

Under the new Act, the securities commissioner must hold a hearing within fifteen days of the statement's filing date.²¹⁴ After the hearing but within those fifteen days, if "the commissioner finds that the takeover offer is unfair or inequitable to the holders of the securities of the target company, or the takeover offer is not made to all offerees on substantially equal terms, he shall by order prohibit the purchase of shares tendered in response to the takeover offer or condition purchase upon changes or modifications."²¹⁵

The requirement under the old Act for the target company, as well as the offeror, to file copies of materials sent to shareholders with the securities commissioner has been eliminated.²¹⁶ Similarly, the antifraud provision of the old Act,²¹⁷ which applied to both target

²⁰⁹*Id.* § 23-2-3.1-8.

²¹⁰The advance notice requirement still presents a problem even though the SEC recently lengthened to 30 days the time a tender offer must remain open. [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 81,935.

²¹¹IND. CODE § 23-2-3-2(e) (1976) (repealed 1979).

²¹²*Id.* § 23-2-3-2(e)-(f).

²¹³*See generally* 1975 Survey, *supra* note 164, at 59.

²¹⁴IND. CODE § 23-2-3.1-7 (Supp. 1979).

²¹⁵*Id.* "Not less than five (5) business days' notice of a hearing must be given to the target company and the offeror." *Id.* § 23-2-3.1-9(c).

²¹⁶*Id.* § 23-2-3-3 (1976) (repealed 1979).

²¹⁷*Id.* § 23-2-3-4.

companies and offerors, does not appear in the new Act. The provision in the old Act which dealt with the securities of the target company that had been tendered was also deleted.²¹⁸

The new Act gives the securities commissioner injunctive powers and the right to obtain judicial relief against violations of the Act similar to the powers granted under the old Act and the Indiana Securities Act.²¹⁹ The new Act, as did the old Act, authorizes the target company, the offeror, or any offeree to bring suit to enjoin violations or to enforce compliance.²²⁰

Notwithstanding the order upholding the new Act entered in *City Investing Co. v. Simcox*,²²¹ the new Act's ultimate fate depends on whether the rationale of the Texas district court and the Fifth Circuit in striking down the Idaho Business Takeover Act in *Great Western* would prevail if the proper case were to reach the Supreme Court.²²² A brief review of the case is necessary for an appreciation of the prospects of the new Act.²²³

A two-fold rationale was behind the Fifth Circuit's decision in *Great Western*. The first ground for striking down the Idaho statute was that it conflicted with and frustrated the clear purpose of the Williams Act amendments to the 1934 Act requiring disclosures by companies making tender offers.²²⁴ As the court noted, the Williams Act was intended to protect shareholders of target companies by requiring disclosure while not unduly impeding cash takeover bids.²²⁵ The Idaho statute destroyed the "careful balance" between the interests of the offeror and those of the management of the target company by tilting the contest in favor of the management. Because it favored management, the statute could have been detrimental to shareholders by discouraging tender offers or by reducing the offer price.²²⁶

²¹⁸*Id.* § 23-2-3-5. See generally 1975 Survey, *supra* note 164, at 58.

²¹⁹Compare IND. CODE § 23-2-1-17.1 (1976) (Securities Act), with *id.* § 23-2-3-8 (1976) (repealed 1979), and *id.* § 23-2-3.1-9(a), -10(a), (c) (Supp. 1979).

²²⁰Compare *id.* § 23-2-3-8(b) (1976) (repealed 1979), with *id.* § 23-2-3.1-10(b), (c) (Supp. 1979). The new Act's provision for judicial review of any final order of the securities commissioner is a similar but more limited version of the old Act's comparable provision. Compare *id.* § 23-2-3-11 (1976) (repealed 1979), with *id.* § 23-2-3.1-11 (Supp. 1979).

²²¹No. IP-79-462-C (S.D. Ind., filed July 27, 1979).

²²²The decisions cited in note 126 *supra* relied on *Great Western* in striking down takeover acts.

²²³The discussion will focus on the Fifth Circuit's opinion, but the rationale of that court and the trial court were basically the same. The *Great Western* decision was first examined and discussed by this author in Galanti, *Business Associations, 1977 Survey of Recent Developments in Indiana Law*, 11 IND. L. REV. 27, 46 (1978) [hereinafter cited as *1977 Survey*].

²²⁴15 U.S.C. §§ 78m(b)-(c), 78n(d)-(f) (1976).

²²⁵577 F.2d at 1277.

²²⁶*Great Western* in fact reduced its initial bid by one dollar because of manage-

The court recognized that federal law did not and could not totally occupy the field of securities regulation,²²⁷ but the court concluded that the Idaho statute was so contrary to the Williams Act in intent and purpose that it was preempted by the latter under the supremacy clause of the Constitution.²²⁸ The statute was also struck down under the commerce clause of the Constitution²²⁹ because it had a substantial effect on interstate commerce and did not accomplish a legitimate local purpose.²³⁰

There are no hard and fast rules which determine when a particular state statute will be deemed preempted by federal legislation. The Supreme Court generally decides preemption cases on a case-by-case basis.²³¹ The court will hold that a state statute or regulation has been preempted by federal legislation or regulations when it finds that Congress intended the federal law to be paramount.²³² It should be noted, however, that recent Supreme Court

ment's opposition to the tender offer. *See* Business Week, Oct. 3, 1977, at 40. The bid was eventually raised, however, when Great Western reached an accord with the target company. *See* The Wall Street Journal, Oct. 6, 1977, at 16, col. 3.

²²⁷Section 18 of the Securities Act of 1933, 15 U.S.C. § 77r (1976), and § 28(a) of the 1934 Act, 15 U.S.C. § 78bb(a) (1976), specifically allow state regulation of securities. *See* SEC v. Nat'l Sec., Inc., 393 U.S. 453, 461 (1969). However, § 28(a) permits state regulation only to the extent that it does not conflict with the federal regulatory scheme.

²²⁸577 F.2d at 1275. *See* U.S. CONST. art. VI, cl. 2.

²²⁹U.S. CONST. art. I, § 8, cl. 3.

²³⁰577 F.2d at 1286. Most commentators have agreed with the Fifth Circuit's decision in *Great Western*. *See generally* Langevoort, *State Tender-Offer Legislation: Interests, Effects, and Political Competency*, 62 CORNELL L. REV. 213 (1977); Wilner & Landy, *The Tender Trap: State Takeover Statutes and Their Constitutionality*, 45 FORDHAM L. REV. 1 (1976); Note, *Commerce Clause Limitations Upon State Regulation of Tender Offers*, 47 S. CAL. L. REV. 1133 (1974). *But see* Note, *Securities Law and the Constitution: State Tender Offer Statutes Reconsidered*, 88 YALE L.J. 510 (1979).

²³¹*See* City of Burbank v. Lockheed Air Terminal, Inc., 411 U.S. 624 (1973), in which the Court stated: "Our prior cases on pre-emption are not precise guidelines in the present controversy, for each case turns on the peculiarities and special features of the federal regulatory scheme in question." *Id.* at 638.

²³²The intent may be found from the express language of the statutes, *see* Goldstein v. California, 412 U.S. 546 (1973); Rice v. Santa Fe Elevator Corp., 331 U.S. 218 (1947); by inference from legislative history, *see* Ray v. Atlantic Richfield Co., 435 U.S. 151 (1978); Huron Portland Cement Co. v. City of Detroit, 362 U.S. 440 (1960); from the comprehensive nature of the congressional legislative scheme, *see* City of Burbank v. Lockheed Air Terminal, Inc., 411 U.S. 624 (1973); Rice v. Santa Fe Elevator Corp., 331 U.S. 218 (1947); from the need to promote a uniform national policy in a particular area, *see* Florida Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132 (1963); San Diego Trades Council v. Garmon, 359 U.S. 236 (1959); or when the state statute or regulation stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress, Hines v. Davidowitz, 312 U.S. 52 (1941).

It should be recognized that the Williams Act is not a pervasive regulatory scheme, and it is conceivable that the Supreme Court could allow the state statutes to stand as a second-line protection for investors. This would recognize the long-accepted

decisions have reflected a hostility toward presuming or inferring congressional intent to preempt a field, and this attitude would certainly help a state defending a takeover statute from a preemption challenge.²³³

The Fifth Circuit in *Great Western* did not, as it could not, find an express intent on the part of Congress to preempt the regulation of tender offers and takeovers when it adopted the Williams Act amendments. The Fifth Circuit relied on the test of *Hines v. Davidowitz*,²³⁴ which preempts state statutes or regulations when they stand as obstacles to the accomplishment and execution of the purposes and objectives of federal legislation. The court invalidated the Idaho statute because its "fiduciary" approach, which examines the fairness of the offer to the shareholders, collided with the "market" approach of the Williams Act, which envisions a scheme leaving the outcome of a takeover attempt to the marketplace by providing adequate information to the offerees.²³⁵

Because many of the blatantly pro-management features, such as the right of the target company to request a hearing by the securities commissioner and the exemption of the friendly tender offer, have been eliminated from Indiana's statute, the new Act is a decided improvement over the old Act. However, the new Act still has a "fiduciary" cast to it that might conflict with the balanced "market" approach of the Williams Act and thus prove fatal under the reasoning of *Great Western*.

For example, the advance filing requirement gives the management of the target company valuable additional time, not available under the Williams Act, during which it can work to defeat the offer.²³⁶ Furthermore, the right of the securities commissioner to block a tender offer which he finds to be "unfair or inequitable to the holders of the securities of the target company," or which "is not made to all offerees on substantially equal terms" gives him the power to stop a takeover attempt that has satisfied all the disclosure requirements of the Williams Act.²³⁷

As already noted, one major difference between the two takeover acts is that under the new Act the extensive disclosure requirements apply only to takeover offers which are not subject to

state role in the securities area. See Merrill, Lynch, Pierce, Fenner & Smith, Inc. v. Ware, 414 U.S. 117, 137 (1973). See generally Note, *Securities Law and the Constitution: State Tender Offer Statutes Reconsidered*, 88 YALE L.J. 510, 519-20 (1979).

²³³See, e.g., Exxon Corp. v. Governor of Maryland, 437 U.S. 117, 132 (1978); DeCanas v. Bica, 424 U.S. 351 (1976); New York State Dep't of Social Serv. v. Dublino, 413 U.S. 405 (1973).

²³⁴312 U.S. 52 (1941).

²³⁵577 F.2d at 1276-81.

²³⁶IND. CODE § 23-2-3.1-3 (Supp. 1979).

²³⁷*Id.* § 23-2-3.1-7.

any requirement of federal law.²³⁸ The ultimate success of this stratagem remains to be seen. Certainly, the burden imposed on offerors subject to the Williams Act has been lessened, but this is irrelevant if the entire scheme of the new Act, which gives management advance notice of the offer and which gives the securities commissioner authority to, in effect, regulate the substantive terms of the tender offer, is still an "obstacle" in the way of the federal scheme established by the Williams Act. It appears that the new Act's scheme is such an obstacle. In fact, it is possible if not probable that the only way to insure that a takeover statute would survive a preemption challenge would be to exclude tender offers for target companies that are subject to the Williams Act.²³⁹

Even if the new Act can withstand a challenge on preemption grounds, it might fall under the commerce clause rationale of *Great Western*. The new Act's jurisdictional scope has been narrowed by making it applicable only to target companies that are organized under the laws of Indiana, have their principal places of business in this state, and have substantial assets in this state.²⁴⁰ The impact on interstate commerce is much less than under the old Act, but it might still be too much. Cash tender offers for such targets will continue to involve interstate commerce because the mail, telephones, and other instrumentalities of interstate commerce will be used. The new Act does not require the offerees to be citizens or residents of Indiana, even though the target company must have close Indiana ties. Thus, the new Act still has extraterritorial effects because it applies to offers to persons who have no connection with Indiana other than owning shares of an Indiana corporation.

Consequently, the requisite local public interest and benefit that sustain state statutes affecting interstate commerce might be absent.²⁴¹ Protecting Indiana investors is a legitimate state interest, but this interest might not be sufficiently pervasive to save a statute which applies to investors in other states as well. A state's interest in the benevolent management of a corporation, which can influence the corporation's commitment to a community and the nature of life in the community, was also recognized by the Fifth Circuit in *Great Western*.²⁴² This interest is laudable and legitimate, but the burdens imposed on interstate commerce might be disproportionate to the legitimate benefits. Of course, an intent to

²³⁸See notes 203-07 *supra* and accompanying text.

²³⁹In other words, it might be necessary to exclude tender offers for companies that are registered under § 12 of the 1934 Act. 15 U.S.C. § 78l (1976).

²⁴⁰See notes 193-95 *supra* and accompanying text.

²⁴¹See, e.g., *Pike v. Bruce Church*, 397 U.S. 137 (1970); *Huron Portland Cement Co. v. City of Detroit*, 362 U.S. 440 (1960).

²⁴²577 F.2d at 1286.

protect incumbent management or prevent the removal of local businesses from Indiana is clearly not legitimate when a burden is imposed on interstate commerce.²⁴³

The purpose of the new Act ostensibly is to provide Indiana shareholders with adequate information about a tender offer and to give them adequate time to respond intelligently. This again is laudable, but the Act may have gone too far. It has been recognized that "[s]tate tender offer regulations can permissibly promote this legitimate local interest [protection of resident shareholders] only if they are limited to the protection of state residents and the regulation of essentially intrastate transactions."²⁴⁴ In other words, to withstand a commerce clause challenge, the takeover statute might have to adopt the traditional Blue Sky approach, which would limit application strictly to Indiana transactions.²⁴⁵

Although the answer is far from certain, it is distinctly possible that the new Act is constitutionally flawed. The Act maintains a "fiduciary approach" as contrasted with the "market approach" of the Williams Act, and could be preempted as an obstacle to the accomplishment of the purposes of the federal statute. Although the jurisdictional scope of the new Act has been narrowed, which improves its prospects under a commerce clause attack, the new Act can operate to deprive shareholders in other states of an opportunity to accept a cash tender offer. This could place an intolerable burden on interstate commerce even when balanced with the benefits. The new Act thus appears designed to protect the "ins" and "locals" from "outsiders" and "[l]ike most legislation which is xenophobic and parochial, [the new Act like other] state bulwarks against 'raiding' . . . [is] often offensive to common sense."²⁴⁶

²⁴³See *Pike v. Bruce Church, Inc.* 397 U.S. 137 (1970); 577 F.2d 1256.

²⁴⁴Note, *Securities Laws and the Constitution: State Tender Offer Statutes Reconsidered*, 88 YALE L.J. 510, 529 (1979).

²⁴⁵*Id.* See also E. ARANOW & H. EINHORN, TENDER OFFERS FOR CORPORATE CONTROL 157 (1973); E. ARANOW & H. EINHORN & G. BERLSTEIN, DEVELOPMENTS IN TENDER OFFERS FOR CORPORATE CONTROL 231 (1977). However, even if the Act were so amended, it would still be necessary to determine whether it protected investors or furthered other legitimate state interests without unduly burdening interstate commerce. It is not clear that commerce would not be burdened. An offeror might still have to comply with other tender offer statutes, and although the right of management to demand a hearing has been eliminated, the mandatory hearing requirement can be burdensome to an offeror faced with similar hearing requirements under other statutes. Furthermore, there is still the advance notification requirement which appears to benefit incumbent management rather than the shareholders. Protection of management rather than shareholders is not a legitimate state interest; thus, it would seem that the requirement would be an impermissible burden on interstate commerce.

²⁴⁶See generally Gould & Jacobs, *The Practical Effects of State Tender Offer Legislation*, 23 N.Y.L. SCH. L. REV. 399, 402 (1977).

2. *Amendments to the General Corporation and Not-for-Profit Corporation Acts.*—Another significant legislative development was the enactment of Public Law 233,²⁴⁷ which amends various sections of the Indiana General Corporation Act²⁴⁸ and the Indiana Not-for-Profit Corporation Act.²⁴⁹ Although some of the legislative changes are sensible and noncontroversial, others are open to criticism.

One of the major statutory changes was an amendment to section 23-1-2-11(b)²⁵⁰ of the Indiana Act. That section now permits a corporation to have a one-member board of directors, regardless of the number of shareholders.²⁵¹ Previously, the section required that the board of directors of a corporation have at least three members unless there were fewer than three shareholders.²⁵² The amendment can be criticized with respect to form as well as substance.

In terms of form, the statute is deficient insofar as it indirectly, rather than directly, authorizes a one-member board of directors. Although the intent of the legislature and the effect of the new amendment are clear, the language itself could have been more precise. For instance, the legislature might have amended the initial portion of section 23-1-2-11(b) to read: "The board of directors of a corporation shall consist of one or more members. Unless otherwise provided in the articles of incorporation, the number of the directors shall be fixed by the bylaws"

The amendment is defective in substance as well as form. The statutory language permitting a corporation to have only one director when there is more than one shareholder might ease the task of the estate planner whose client wishes to distribute corporate shares to beneficiaries while maintaining complete control of the corporation as the sole director, but the amendment puts the minority shareholders of such a corporation in an unfortunate position by subjecting their interests to the "dictatorial" actions of the sole director. The director is bound by the general statutory re-

²⁴⁷Act of Apr. 9, 1979, Pub. L. No. 233, 1979 Ind. Acts 1089 (codified in scattered sections of IND. CODE tit. 237). The Act is similar to a proposed bill drafted by the office of the Indiana Secretary of State for presentation by the Indiana Corporations Survey Commission to the Indiana General Assembly during its 1978 session.

²⁴⁸IND. CODE §§ 23-1-1-1 to -12-6 (1976 & Supp. 1979) [hereinafter referred to as the Indiana Act].

²⁴⁹IND. CODE §§ 23-7-1.1-1 to -66 (1976 & Supp. 1979).

²⁵⁰*Id.* § 23-1-2-11(b) (Supp. 1979).

²⁵¹Section 23-1-2-11(b) now reads in pertinent part: "Unless otherwise provided in the articles of incorporation, the number of the directors, *whether one (1) or more*, shall be fixed by the by-laws" *Id.* (emphasis added).

²⁵²*Id.* § 23-1-2-11(b) (Supp. 1978) (amended 1979). This former version provided that when all the shares of a corporation were owned beneficially and of record by either one or two persons, the number of directors could be less than three, but not less than the number of shareholders. *Id.*

quirements of good faith and due care, and the minority shareholders can bring a derivative action against a director who abuses his fiduciary power. Nevertheless, it is preferable to prevent or at least lessen the likelihood of a directorial abuse of power than to rely on remedies once it occurs. The old saw is appropriate—an ounce of prevention is worth a pound of cure.

Prior to 1969 the Indiana Act required that a corporation have a minimum of three directors regardless of the number of shareholders. This requirement did not make a great deal of sense for corporations having only one shareholder. In such corporations, the requirement simply served to promote the formation of three-member boards consisting of a sole shareholder, a spouse, and perhaps an attorney or an in-law. Beginning in 1969, however, a corporation with one shareholder could have a one-person board and a corporation with two shareholders could have a two-person board. The requirement of a minimum of three directors applied only to corporations having three or more shareholders.²⁵³ Section 23-1-2-11(b), before it was amended, was sufficiently broad to take into account both one- or two-shareholder corporations, as well as larger corporations in which the interests of a greater number of shareholders were implicated. In the latter case, the shareholders' rights were protected by the requirement of a three-member board, which insured that corporate decisions would be made on a collegial basis.

The foregoing analysis is not blind to the reality that a majority or controlling shareholder can influence the decisions of other directors who can be removed without cause under the Indiana Act.²⁵⁴ Instead, it recognizes that other directors can make beneficial contributions to the corporate decision-making process and can even act as a brake on actions of the controlling shareholder that might be detrimental to the interests of minority shareholders. Legislative elimination of this potential check simply to expedite estate planning appears to be shortsighted.

It can be argued that the legislature has "modernized" the Indiana Act by eliminating the requirement of a minimum number of directors; the drafters of the Model Business Corporation Act eliminated a similar requirement in 1969.²⁵⁵ However, the amendment also can be labeled as further evidence that Indiana has joined

²⁵³IND. CODE ANN. § 25-208 (Burns 1970) (currently codified at IND. CODE § 23-1-2-11(b) (1976) (amended 1979)).

²⁵⁴See IND. CODE § 23-1-2-12 (1976).

²⁵⁵MODEL BUS. CORP. ACT ANN. 2d § 36 (1971). The rationale for removing the minimum requirement was that "[i]t was deemed wise to recognize in the statute the growing practice of one-man management in closed corporations." *Id.* ¶ 2, at 777.

what Justice Brandeis' dissent in *Liggett Co. v. Lee*²⁵⁶ characterized as a "race . . . of laxity."²⁵⁷ It seems that every time the Model Act is revised under the rubric of "modernization," the interests of shareholders, as opposed to those of management, are sacrificed.²⁵⁸ The same subordination of shareholders' interests seems to be true of recent amendments to the Indiana Act.²⁵⁹

Another possible problem with the one-member board is that the director might have difficulty differentiating his individual interests from the interests of the corporation. As a result, the formality of the corporate structure might be compromised. In other words, the sole director of a corporation might be subjected to personal liability if the "corporate veil" were pierced. If there were a multimember board, however, the likelihood of personal liability in the event of "piercing" would be reduced.²⁶⁰ Of course, it can be assumed that in corporations with many shareholders, or few shareholders who have personal interests to protect, multimember boards will be the rule. Nevertheless, by permitting one person to form a corporation which ultimately will have more than three shareholders but which will have only one director, the legislature has created a potential problem which does not appear to be warranted simply for the sake of convenience for estate planners.

Another significant change in the Indiana Act relates to the procedures for reinstating a corporation whose term of existence as fixed by its articles of incorporation has expired. In 1977, the legislature adopted section 23-3-4-1.6,²⁶¹ which governs the reinstatement of those corporations whose terms of existence have expired and whose articles of incorporation have been forfeited for failure to file annual reports. The 1977 version required such corporations to

²⁵⁶288 U.S. 517 (1933).

²⁵⁷*Id.* at 559 (Brandeis, J., dissenting).

²⁵⁸See generally Eisenberg, *The Model Business Corporation Act and the Model Business Corporation Act Annotated*, 29 BUS. LAW. 1407 (1974).

²⁵⁹For example, § 23-1-2-11 of the Indiana Act, amended in 1979, was also amended in 1977. Act of Apr. 22, 1977, Pub. L. No. 76, § 3, 1977 Ind. Acts 380 (current version at IND. CODE § 23-1-2-11 (Supp. 1979)). At that time, the legislature adopted the affirmative duty of care of a director described in § 35 of the Model Act. MODEL BUS. CORP. ACT ANN. 2d § 35 (Supp. 1977). That amendment, criticized in the 1977 *Survey*, *supra* note 223, at 47-50, in effect reduced the duty of care of outside directors who might be the only persons able to police management.

²⁶⁰Although the likelihood of personal liability is relatively low in the case of a three-member board, it is fairly high in the case of a one-person corporation. Nonetheless, since 1969 the Indiana Act has permitted such a corporation to have only one director.

²⁶¹Act of Apr. 22, 1977, Pub. L. No. 76, § 10, 1977 Ind. Acts 397 (codified at IND. CODE § 23-3-4-1.6 (Supp. 1977) (amended 1979)). See 1977 *Survey*, *supra* note 223, at 50-51.

make application to the secretary of state for reinstatement.²⁶² Upon approval of the application, the corporation was "deemed to have continuously existed since the date of termination of its existence as fixed by its articles of incorporation."²⁶³

Also in 1977 the legislature amended section 23-1-7-4,²⁶⁴ dealing with dissolution by expiration of term of existence, to correspond with section 23-3-4-1.6.²⁶⁵ Under the prior version of section 23-1-7-4, a corporation whose term of existence had expired could extend its duration by amending its articles of incorporation.²⁶⁶ Under the 1977 amendment, however, a corporation seeking to extend its term of existence under section 23-3-4-1.6 had to apply to the secretary of state for reinstatement.²⁶⁷

One problem with the 1977 versions of sections 23-3-4-1.6 and 23-1-7-4 was that the duration of reinstatement of a corporation whose term of existence had expired was not clear. This problem has been remedied in part by the new amendment to section 23-1-7-4, which provides that when a corporation whose term of existence has expired seeks to be reinstated it not only must make application to the secretary of state for reinstatement but also it must "amend its articles of incorporation to provide for an increase in its term of existence."²⁶⁸

Section 23-3-4-1.6 was similarly amended. A corporation whose term of existence has expired must include in its application for reinstatement "[a]mendments to its articles of incorporation increasing its term of existence."²⁶⁹

Nevertheless, the approach taken by the legislature raises a new problem. It is arguable that the original version of section 23-3-4-1.6 automatically gave perpetual duration to a reinstated corporation. An expired corporation applying for reinstatement is likely to seek perpetual reinstatement, even when the original selection of limited duration was deliberate.²⁷⁰ Of course, if those responsible for seeking reinstatement of the corporation wished to limit its duration, the articles of incorporation could be amended by the regular amendment procedure of the Indiana Act.²⁷¹

²⁶²IND. CODE § 23-3-4-1.6(a) (Supp. 1977) (amended 1979).

²⁶³*Id.* § 23-3-4-1.6(c).

²⁶⁴Act of Apr. 22, 1977, Pub. L. No. 76, § 4, 1977 Ind. Acts 385 (codified at IND. CODE § 23-1-7-4 (Supp. 1977) (amended 1979)).

²⁶⁵IND. CODE § 23-3-4-1.6 (Supp. 1977) (amended 1979).

²⁶⁶*Id.* § 23-1-7-4 (1976) (amended 1977 & 1979).

²⁶⁷*Id.* (Supp. 1977) (amended 1979).

²⁶⁸*Id.* (Supp. 1979).

²⁶⁹*Id.* § 23-3-4-1.6(a)(3) (Supp. 1979).

²⁷⁰*See 1977 Survey, supra* note 223, at 51. Admittedly, one problem with this approach would be that a corporation reinstated with automatic perpetual duration under section 23-3-4-1.6 would still have a set of articles containing a limited term.

²⁷¹IND. CODE §§ 23-1-4-1 to -7 (1976).

The 1979 amendment to section 23-3-4-1.6 resolves an additional problem under the original version. As initially adopted, section 23-3-4-1.6(b) provided:

If the officer or director who files the affidavit [for reinstatement] was not . . . named in the last preceding timely-filed annual report, the affidavit shall also be signed by a person who was an officer or director at such time, or . . . be accompanied by evidence that notice of intent . . . to seek reinstatement has been sent to the last known address of the resident agent and every officer named on the last timely-filed annual report at least thirty . . . days prior to the filing of the affidavit.²⁷²

The 1979 version adds a sentence to the above-quoted language to provide for the situation in which no annual report has been filed. In such a case, "notice of intent . . . to seek reinstatement . . . [must be] sent to all incorporators and directors named in the articles of incorporation of the corporation."²⁷³

A third worthwhile change secured by Public Law 233 was the elimination of the requirement that annual reports of both domestic and foreign corporations be signed by two principal officers and acknowledged and sworn to before a notary public.²⁷⁴ Now, annual reports need be signed only by any current officer of the corporation and verified and affirmed under penalties of perjury.²⁷⁵ Simplification of the reporting requirements of corporations is a development worth encouraging. With simplified procedures, more small corporations may "get into the habit" of filing the annual reports required by law. Furthermore, any simplification will tend to reduce the number of articles of incorporation—certificates of admission in the case of foreign corporations—which are revoked because of carelessness and inattention to the requirements of the Indiana Act.

No changes similar to the ones made in the Indiana Act provisions on annual reports were made in the annual report provision of the Indiana Not-for-Profit Corporation Act.²⁷⁶ However, none were necessary because that section does not require the signature of the two principal officers,²⁷⁷ and the annual report form which the secretary of state has prepared can apparently be signed by any current officer subject to the penalties of perjury. The amendments

²⁷²*Id.* § 23-3-4-1.6(b) (Supp. 1977) (amended 1979).

²⁷³*Id.* § 23-3-4-1.6(b) (Supp. 1979).

²⁷⁴*Id.* §§ 23-1-8-1, -11-7 (1976); *id.* § 23-3-4-1.

²⁷⁵*Id.* §§ 23-1-8-1, -3-4-1 (Supp. 1979).

²⁷⁶*Id.* § 23-7-1.1-36 (1976).

²⁷⁷*Id.*

to the annual report provisions do not change the requirement that annual reports of corporations must be made on forms prescribed and furnished by the office of the secretary of state.²⁷⁸

Public Law 233, by an amendment to section 23-3-4-1, also clarified and ratified the authority of the secretary of state to revoke the articles of incorporation of domestic corporations and the certificates of admission of foreign corporations which fail to file annual reports for a period of two years.²⁷⁹ Before section 23-3-4-1 was amended, it was not absolutely clear that the secretary of state had the authority to revoke certificates of admission of foreign corporations. Arguably, he did not, although no one apparently challenged the practice. The amendment to section 23-3-4-1 also clarified the notification requirements and procedures which must be followed before articles of incorporation or a certificate of admission may be revoked. The secretary of state must give at least thirty-days notice by first-class mail to a corporation which has not filed annual reports for two years that its articles or certificate may be revoked. If the corporation fails to make the necessary filings within the thirty-day period, notice must be "published in a newspaper of general circulation in the county in which [the] corporation's principal office is located."²⁸⁰ If the corporation has not yet made the required filings within thirty days after such publication, the secretary of state is charged with revoking the rights and privileges and declaring that the articles of incorporation or certificate of admission of the corporation are forfeited.²⁸¹

The 1979 amendment to section 23-7-1.1-2 of the Indiana Not-for-Profit Corporation Act substitutes the term "acceptance" for "reorganization" to denote the process whereby not-for-profit corporations formed before the effective date of the Act may elect to accept its provisions.²⁸² There was no reason for that change. "Acceptance" rather than "reorganization" should have been the term used in the Act as originally passed because "reorganization" was not used in any other portion of the Act. Now, however, section 23-7-1.1-9 of the Act also employs the term "reorganization."²⁸³ Public

²⁷⁸[1950] OP. IND. ATT'Y GEN. 22, 24.

²⁷⁹IND. CODE § 23-3-4-1 (1976 & Supp. 1979). The amendment to this section specifically refers to not-for-profit as well as for-profit corporations. The secretary of state should have authority to revoke the articles of delinquent not-for-profit corporations, but it might have been better to have explicitly stated that authority in § 23-7-1.1-36 of the Indiana Not-for-Profit Corporation Act rather than in the annual report statute, which is, or at least arguably is, directed only at for-profit corporations.

²⁸⁰*Id.* § 23-3-4-1 (1976 & Supp. 1979).

²⁸¹*Id.* The secretary of state must endorse the articles of incorporation or the certificate of admission to indicate forfeiture for failure to file annual reports. *Id.*

²⁸²*Id.* §§ 23-7-1.1-2(a), -2(c).

²⁸³*Id.* § 23-7-1.1-9.

Law 233 changes the quorum²⁸⁴ and voting²⁸⁵ requirements with respect to meetings called for the purpose of accomplishing fundamental changes in not-for-profit corporations. These fundamental changes include *reorganizations*. The discrepancy in terminology should not cause any problems because “reorganization” as employed in section 23-7-1.1-9 encompasses “articles of acceptance.” Nevertheless, the Bill should have been examined for internal consistency before it was adopted. Housekeeping amendments remedying the inconsistency are in order.²⁸⁶

The substantive changes in the voting provision²⁸⁷ can be criticized because they create the potential for a small group of insiders to gain virtual control of a not-for-profit corporation. The changes do, however, solve the problem created by large or lethargic memberships which cannot be motivated to attend meetings during which important corporate changes are to be considered. The methods provided for alleviating the problem are the right to establish voting rights²⁸⁸ and to define a quorum²⁸⁹ when the corporation is formed. Previously, however, if the articles of incorporation did not anticipate the problem, for example when they provided that the bylaws were to be adopted by the members and not by the board of directors, a majority of the members would have had to approve an amendment vesting that authority in the board of directors.²⁹⁰ In other words, if a “mistake” were made when the corporation was first formed, it might be difficult, if not impossible, to remedy without the changes to section 23-7-1.1-9. There is the risk

²⁸⁴*Id.* § 23-7-1.1-9(f) (Supp. 1979) provides:

in cases of a meeting called for the purpose of voting on a proposed amendment to the articles of incorporation, merger, consolidation, reorganization, special corporate transaction, or voluntary dissolution, . . . a quorum shall be constituted by those members that are otherwise entitled to vote in respect thereof and that are present, in person or by proxy, at the meeting at which such vote is conducted.

²⁸⁵*Id.* § 23-7-1.1-9(e) provides that members entitled to vote on fundamental changes include “only those members that are otherwise entitled to vote with regard to such matter and who are present, in person or by proxy, at the meeting at which such vote is conducted, and whose presence at such meeting constitutes a quorum as defined in subsection (f).” *See* note 217 *supra*.

²⁸⁶A possible solution to the conflict between the language added to IND. CODE §§ 23-7-1.1-9(c), -9(f) (Supp. 1979), and that of the definition section, *id.* § 23-7-1.1-2 (1976 & Supp. 1979), would be to amend the former sections to substitute the term “acceptance” for “reorganization,” because the act in fact contemplates the use of articles of acceptance when a corporation formed under some other not-for-profit corporation statute becomes subject to the Indiana Not-for-Profit Corporation Act.

²⁸⁷*See* note 285 *supra*.

²⁸⁸IND. CODE § 23-7-1.1-9(e) (Supp. 1979).

²⁸⁹*Id.* § 23-7-1.1-9(f).

²⁹⁰*Id.* § 23-7-1.1-9(e) (1976) (amended 1979).

that insiders may lock themselves into a control position, but the benefits of relaxing the voting and quorum requirements would seem to offset the risk. Even if the insiders get out of hand, there is nothing to stop all members from attending a meeting to remedy the situation.

Section 23-7-1.1-9 as amended does present a real problem because it seems to conflict at least with section 23-7-1.1-23,²⁹¹ which defines members entitled to vote on proposed amendments to the articles of incorporation. In some situations, members who are not present at a meeting would seem to have a statutory right to vote on proposed amendments. A cleaner approach to solving the problem of the lethargic membership would have been to amend the provisions relating to the voting requirements for particular changes rather than to amend section 23-7-1.1-9(e), which is the general franchise provision of the Indiana Act.

Section 23-7-1.1-10 of the Indiana Not-for-Profit Corporation Act²⁹² was amended to eliminate the requirement that directors of such corporations be members. The change makes the provision consistent with the analogous provision of the Indiana General Corporation Act.²⁹³ This area may not be one in which consistency is appropriate. Many times an outsider who does not own shares of a for-profit corporation is a worthwhile addition to the board of directors. This is not necessarily true of a not-for-profit corporation, and perhaps such an organization should be run by its members. This would be true, for example, of a neighborhood civic league.²⁹⁴ On the other hand, it might be appropriate to permit nonmember directors of, for example, a trade association with corporate but not individual members.

The final change accomplished by Public Law 233 is an amendment to section 23-7-1.1-12²⁹⁵ permitting the articles of incorporation or bylaws of a not-for-profit corporation to "provide that officers are to be elected by the members of the corporation instead of by the board of directors."²⁹⁶ This method of electing officers was available

²⁹¹*Id.* § 23-7-1.1-23 (1976). Section 23-7-1.1-9 does not seem to conflict with the provisions relating to "special corporate transactions," *id.* § 23-7-1.1-31, or dissolution, *id.* § 23-7-1.1-33(2). Those sections respectively refer to the vote of "the members entitled to vote in respect thereof" and the vote of "a majority of the members entitled to vote thereon." *Id.* A proposed merger is an in-between category because under certain circumstances members not present at a meeting of the not-for-profit corporation would be entitled to vote as in cases of amendments to the articles. *Id.* § 23-7-1.1-42(b).

²⁹²*Id.* § 23-7-1.1-10 (Supp. 1979).

²⁹³*Id.* § 23-1-2-11(a)(1).

²⁹⁴Of course, the articles of such an organization can require that directors be members.

²⁹⁵IND. CODE § 23-7-1.1-12 (Supp. 1979).

²⁹⁶*Id.*

under the predecessor to the current act.²⁹⁷ Although there is not clear evidence that many not-for-profit corporations will adopt this alternative, there certainly is no harm in making it available.

3. *Executive Committees, Mergers and Consolidations.*—Public Law 234 is the third piece of legislation affecting the corporate area adopted during the 1979 session of the Indiana General Assembly.²⁹⁸ An amendment to the merger and consolidation provisions of the Indiana Act,²⁹⁹ to provide that shares and other securities or obligations of foreign as well as domestic corporations could be issued in connection with mergers or consolidations, was a noncontroversial but perhaps unnecessary change. The references to “any corporation” in the merger provision³⁰⁰ and to “any other corporation” in the consolidation provision,³⁰¹ which had been the operative language of the merger and consolidation provisions since 1969, were broad enough to include both domestic and foreign corporations. Nothing in these sections intimated that the shares, securities, or obligations had to be those of an Indiana corporation. By making the language express, though, the provisions eliminate a remote ground for an attack on a merger or consolidation because securities of a foreign corporation were issued.

In 1969 the drafters of the Model Act amended the merger and consolidation provisions³⁰² to permit the conversion of shares of merging or consolidating corporations into shares, other securities, or obligations of the surviving corporation, the new corporation, or “any other corporation.”³⁰³ It is difficult to believe that the revisers of the Model Act would have omitted the terms “domestic or foreign” while liberalizing the Act if they had any doubts about the sufficiency of the phrase “any other corporation.”³⁰⁴

²⁹⁷*Id.* § 23-7-1.1-17 (1971) (current version at *id.* § 23-7-1.1-12 (Supp. 1979)).

²⁹⁸Act of Apr. 10, 1979, Pub. L. No. 234, § 1, 1979 Ind. Acts 1106.

²⁹⁹IND. CODE §§ 23-1-5-2(a)(3), -3(a)(3) (1976 & Supp. 1979).

³⁰⁰*Id.* § 23-1-5-2(a)(3) (1976) (amended 1979).

³⁰¹*Id.* § 23-1-5-3(a)(3).

³⁰²MODEL BUS. CORP. ACT ANN. 2d §§ 71(c), 72(c) (1971).

³⁰³*Id.* Before the amendment, these sections only permitted conversion into shares, other securities, or obligations of the surviving or new corporation which, according to the comments, “seemed to be needlessly restrictive and out of harmony with modern practices.” *Id.* ¶ 2, at 352.

³⁰⁴The merger provision of the Indiana Financial Institutions Act, IND. CODE §§ 28-1-7-1 to -24 (1976), was amended in 1979 to permit the conversion of shares into those of “any other corporation.” Act of Apr. 6, 1979, Pub. L. No. 257, § 16, 1979 Ind. Acts 1283 (codified at IND. CODE § 28-1-7-2 (Supp. 1979)). The legislature did not use the current language of IND. CODE § 23-1-5-2 (Supp. 1979) as the model for the Indiana Financial Institutions Act, but instead used the language of § 23-1-5-2 as it existed prior to 1972. If the difference between the language of § 28-1-7-2 and § 23-1-5-2 (as amended) reflect a public policy, then only shares of domestic corporations can be issued in a merger of financial institutions. Of course, one possible

The wisdom of another provision of Public Law 234 can be questioned. The Act amends section 23-1-2-11(g) of the Indiana Act pertaining to executive and other committees of the board of directors. The new provision appears to be based in part on the 1975 revision of section 42 of the Model Act,³⁰⁵ but the provision goes beyond the Model Act in one significant respect.³⁰⁶ Under the Model Act, an executive committee has limited authority over the sale or issuance of securities in instances in which the board of directors generally has authorized the specific transaction in a resolution or by adoption of a stock option plan. Under the Indiana provision, however, complete authority may be given to an executive committee to sell or issue securities without any prior action by the board of directors.³⁰⁷

Such authority is not the kind that should be delegable to an executive committee. Apparently, this is the attitude of the drafters of the Model Act. The Model Act provides a standard that prohibits delegation of authority over actions "substantially affecting the rights of shareholders among themselves . . . matters of a character

explanation for the different language, which receives credence from the fact that § 28-1-7-11(c) of the Indiana Financial Institutions Act pertaining to consolidations of financial institutions was not amended at the same time, is poor legislative drafting in which obsolete language was used as a model.

³⁰⁵MODEL BUS. CORP. ACT ANN. 2d § 42 (Supp. 1977).

³⁰⁶Section 23-1-2-11(g) of the Indiana Act now provides in pertinent part:

[T]o the extent provided in the resolution, the articles of incorporation, or the by-laws, [an executive or other committee] may exercise all the authority of the board of directors including, but not limited to, the authority to issue and sell or approve any contract to issue and sell, securities or shares of the corporation or designate the terms of a series of a class of securities or shares. The terms which may be affixed by that committee include, but are not limited to, the price, dividend rate, and provisions of redemption, a sinking fund, conversion, voting, or preferential rights or other features of securities or class or series of a class of shares. The committee has full power to adopt a final resolution which sets forth those terms and to authorize a statement of terms to be filed with the secretary of state.

IND. CODE § 23-1-2-11(g) (1976 & Supp. 1979).

Section 42(viii) of the Model Act provides that

no . . . [executive] committee shall have authority to . . . authorize or approve the issuance or sale of, or any contract to issue or sell, shares or designate the terms of a series of a class of shares, provided that the board of directors, having acted regarding general authorization for the issuance or sale of shares, or any contract therefor, and in the case of a series, the designation thereof, may, pursuant to a general formula or method specified by the board by resolution or by adoption of a stock option or other plan, authorize a committee to fix the terms of any contract for the sale of the shares and to fix the terms [of the transaction]

MODEL BUS. CORP. ACT ANN. 2d § 42(viii) (Supp. 1977).

³⁰⁷Originally, § 42 of the Model Act appears to have *permitted* the delegation of such authority to an executive committee, but this authority was restricted in 1975. See MODEL BUS. CORP. ACT ANN. 2d § 42 ¶ 2 (Supp. 1977).

of immediate and irrevocable effect (such as the declaration of a dividend) . . . matters which may well become irrevocable without swift action, and . . . matters which will cause changes of position by others which cannot be rectified."³⁰⁸ The Model Act recognizes that a decision to sell or issue securities is not one that the entire board of directors easily can reverse or rescind. Furthermore, the delegation of such a decision can aggravate the conflict created when one faction of a divided board controls the executive committee and uses the authority to further enhance its position in the corporation.³⁰⁹

Public Law 234 also amended the statutory restrictions on the authority of an executive committee. Six specific actions are beyond the authority of an executive committee.³¹⁰ These restrictions are similar to the restrictions of the Model Act,³¹¹ except in one respect. Whereas the Model Act prohibits an executive committee from approving or recommending to shareholders actions or proposals requiring shareholder approval, or from approving plans of merger not requiring shareholder approval,³¹² section 23-1-2-11(g), as amended, only prohibits an executive committee from approving a plan of merger or consolidation.³¹³ If the drafters of the new provision intended to parallel the Model Act, they managed to open a rather large gap. Under the Model Act, an executive committee cannot approve a merger, consolidation, or sale of all or substantially all of the corporation's assets because such a sale requires shareholder approval. Under section 23-1-2-11(g)(3), mergers or consolidations cannot be approved by an executive committee, but a sale of all the assets of the corporation³¹⁴ can be recommended by an executive committee because there is no restriction pertaining to matters requiring shareholder approval. Before the 1979 amendment, section 23-1-2-11(g) restricted the executive committee from proposing special corporate transactions.³¹⁵ If the legislature intended to omit special corporate transactions, it again made an unwise decision because such transactions can substantially affect the rights of

³⁰⁸*Id.* Admittedly, the drafters of the Model Act permit the delegation of some authority to act with respect to matters arising outside the ordinary course of business, but the authority delegated by § 23-1-2-11(g) involves transactions that are more appropriately left to a determination by the entire board of directors.

³⁰⁹An executive committee may be prohibited from pursuing this type of action, however. There is authority that the issuance of shares simply to thwart a shift of control is a breach of fiduciary duty. *See, e.g., Condec Corp. v. Lunkenheimer Co.*, 43 Del. Ch. 353, 230 A.2d 769 (1967).

³¹⁰IND. CODE §§ 23-1-2-11(g)(1)-(6) (Supp. 1979).

³¹¹MODEL BUS. CORP. ACT ANN. 2d §§ 42(i)-(viii) (Supp. 1977).

³¹²*Id.* §§ 42(ii), (v).

³¹³IND. CODE § 23-1-2-11(g)(3) (1976 & Supp. 1979).

³¹⁴*Id.* §§ 23-1-6-1 to -5.

³¹⁵*Id.* § 23-1-2-11(g) (1976) (amended 1979).

shareholders. If the legislature did not so intend and felt that it was paralleling the restrictions of the Model Act, it can be charged with poor legislative drafting.³¹⁶

The basic procedures for establishing executive committees were also changed by Public Law 234. For some inexplicable reason, the phrase "or the bylaws" was added to the first sentence of section 23-1-2-11(g), which now reads:

Unless otherwise provided in the articles of incorporation or the bylaws, the board of directors may, by resolution adopted by a majority of the actual number of directors elected and qualified, from time to time, pursuant to a provision of the by-laws, designate from among its members and executive committee³¹⁷

The amendment is inexplicable because under the prior language an executive committee could be appointed pursuant to a bylaw, unless otherwise provided in the articles of incorporation. The new statute's provision that the authority to appoint an executive committee can be restricted by a bylaw provision is unnecessary because a bylaw provision is always essential for implementing the appointment of an executive committee. Under the old statute, if the corporation did not want an executive committee, it simply refused to adopt a bylaw. The added language is superfluous. The drafters of the Indiana legislation might have been influenced again by section 42 of the Model Act, which does refer to bylaws. If this was the case, the drafters failed to make a thorough reading of the Model Act, which authorizes the appointment of an executive committee if the articles of incorporation or the bylaws so provide.³¹⁸ The Indiana Act, in contrast, provides that the board of directors has the power to appoint an executive committee unless restricted by the articles of incorporation or the bylaws.³¹⁹

Finally, section 23-1-2-11(g) was amended by adding a paragraph that provides: "A member of the board of directors is not liable for

³¹⁶Unfortunately, the latter might be the case because *id.* § 23-1-2-11(g)(5) restricts an executive committee from authorizing or approving "the reacquisition of shares unless pursuant to a general formula or method specified by the board of directors," which is identical to § 42(vii) of the current version of the Model Act. There was no such restriction in the prior language of § 23-1-2-11(g). The drafters of the Model Act apparently considered the reacquisition transaction the mirror image of the issuance of shares, which is restricted. This further demonstrates the anomaly of permitting executive committees of Indiana corporations to approve and authorize security transactions unless restricted in the resolution, articles of incorporation, or bylaws.

³¹⁷IND. CODE § 23-1-2-11(g) (1976 & Supp. 1979).

³¹⁸MODEL BUS. CORP. ACT ANN. 2d § 42 (Supp. 1977).

³¹⁹IND. CODE § 23-1-2-11(g) (1976 & Supp. 1979).

any action taken by a committee if he is not a member of that committee and has acted in good faith and in a manner he reasonably believes is in the best interest of the corporation."³²⁰ On its face, this provision appears less restrictive than the comparable language in section 42 of the Model Act.³²¹ The effect of the two provisions will probably be similar, however, because under section 42 a noncommittee director does not automatically incur liability if the executive committee action fails to meet the statutory standard of care.³²² Liability will probably depend on such factors as the care used in the delegation to and the surveillance of the executive committee and the knowledge about the particular matter available to the noncommittee director.³²³

³²⁰*Id.*

³²¹The Model Act provides:

Neither the designation of any such committee, the delegation thereto of authority, nor action by such committee pursuant to such authority shall alone constitute compliance by any member of the board of directors, not a member of the committee in question, with his responsibility to act in good faith, in a manner he reasonably believes to be in the best interests of the corporation, and with such care as an ordinarily prudent person in a like position would use under similar circumstances.

MODEL BUS. CORP. ANN. 2d § 42 (Supp. 1977).

³²²*Id.* ¶ 2. The comment to § 42 of the Model Act points out that directors may not abdicate their responsibilities and receive exoneration from liability simply by delegating authority to an executive or other committee of the board of directors. *Id.*

³²³*Id.*