

II. Business Associations

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A. Shareholder Derivative Actions

Neese v. Richer,¹ decided during the survey period, should be of particular interest to attorneys who represent closely held corporations and to attorneys who represent minority shareholders of such corporations. In *Neese*, the court of appeals affirmed an order of the Montgomery Circuit Court that awarded attorney fees and expenses to the plaintiff, Richer, in a shareholder derivative action.² The plaintiff sought an accounting and damages, alleging mismanagement of the corporate defendant, improper recordkeeping, fraud, and conversion of corporate funds to the directors' personal use.³

The trial court had ordered an audit of the corporation's books by an independent accounting firm.⁴ Following receipt of the independent accountant's report, the trial court found that Richer had failed to prove the defendants were guilty of fraud, mismanagement, or conversion even though Richer had proven that the defendants were guilty of certain "improper" acts.⁵ However, the court then concluded that Richer had been justified in filing the suit because the defendants had failed to keep correct and complete financial books and records of account as required by the Indiana General Corporation Act,⁶ and because the defendants' dealings with the corporation "were sufficiently susceptible of an interpretation of wrongdoing."⁷ Consequently, the trial court ordered the corporation to pay Richer's expenses, the costs of the action, and the accountant's fee, even though the suit did not generate a financial recovery for the corporation.⁸

The first issue resolved on appeal was the propriety of ordering the corporation to pay for the independent accounting. Relying on *Atwood v. Prairie Village, Inc.*,⁹ the *Neese* court held that allowing

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¹428 N.E.2d 36 (Ind. Ct. App. 1981).

²*Id.* at 43.

³*Id.* at 37.

⁴*Id.* Defendants had unsuccessfully attempted to secure a writ of mandate and prohibition preventing the trial judge from acting in connection with the independent accounting order. See *State ex rel. Neese v. Montgomery Circuit Court*, 399 N.E.2d 375 (Ind. 1980).

⁵428 N.E.2d at 37.

⁶IND. CODE § 23-1-2-14 (1982).

⁷428 N.E.2d at 38.

⁸*Id.*

⁹401 N.E.2d 97 (Ind. Ct. App. 1980). The *Atwood* court in turn had relied on an earlier related Indiana Supreme Court decision, *State ex rel. Neese v. Montgomery Circuit Court*, 399 N.E.2d 375 (Ind. 1980).

costs in an equitable action, such as an accounting, is within the discretion of the trial court, and the court of appeals will not interfere unless this discretion is manifestly abused.¹⁰ In *Atwood*, it made no difference that the accountant's fee was assessed against the unsuccessful plaintiff. Clearly, this factor should not make a difference in determining who pays the accountant's fee; the main issue is which party equitably should bear the expenses. The *Neese* court was satisfied that assessing the fee against the corporation was proper in light of the trial court's "findings that the corporation's accounting procedures were sloppy, disorganized, and extremely difficult to follow"¹¹ in substantiating and reconciling the accounts and records that were available.

The message of this aspect of *Neese* is clear, unambiguous, and should be brought home to corporate clients who take a cavalier attitude toward proper bookkeeping and recordkeeping. The Indiana General Corporation Act requires corporations to keep correct and complete books of account.¹² Those that fail to comply with the statutory mandate at least face the prospect of paying for an independent audit if a minority shareholder brings a colorable, although not totally successful, action for an accounting. A much wiser course is to avoid the *Neese* problem by keeping the proper books and records.

An even more significant aspect of *Neese* is the fact that the appellate court affirmed the award of attorney fees and expenses. Indiana has long recognized the propriety of such an award where a shareholder has successfully prosecuted a derivative suit that resulted in some actual pecuniary benefit to the corporation.¹³ There are two policies for this rule: (1) shareholders who benefit from another shareholder's efforts to recover a fund for the corporation would be unjustly enriched if they did not contribute to the litigation expenses, and (2) failure to reimburse the shareholder's expenses would discourage shareholders from bringing meritorious derivative suits if the fees and expenses would exceed any potential increase in the value of their shares.¹⁴

¹⁰428 N.E.2d at 38-39.

¹¹*Id.* at 39.

¹²IND. CODE § 23-1-2-14 (1982).

¹³See *Cole Real Estate Corp. v. Peoples Bank & Trust Co.*, 160 Ind. App. 88, 310 N.E.2d 275 (1974), discussed in Galanti, *Business Associations, 1974 Survey of Recent Developments in Indiana Law*, 8 IND. L. REV. 24, 35-42 (1974). See also *Princeton Coal & Mining Co. v. Gilchrist*, 51 Ind. App. 216, 99 N.E. 426 (1912). See generally authorities cited *infra* note 14.

¹⁴428 N.E.2d at 39. See generally 13 W. FLETCHER, *CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS* § 6044 (rev. perm. ed. 1980). Professor Hornstein's four articles on counsel fees in derivative actions are considered to be the leading commentary on the issue. See Hornstein, *The Counsel Fee in Stockholder's Derivative Suits*, 39 COLUM. L. REV. 784 (1939); Hornstein, *Problems of Procedure in Stockholder's Derivative Suits*, 42 COLUM. L. REV. 574 (1942); Hornstein, *New Aspects of Stockholder's Derivative Suits*, 47

Defendants first argued that the award was inappropriate because Richer's suit was "not successful." This argument was summarily rejected in that the trial court specifically had found that an accounting was proper under the circumstances even though the defendants were not guilty of fraud, mismanagement, or conversion of corporate assets. Thus, Richer's suit was "successful."¹⁵

Defendant's second argument was that Richer could not recover his expenses because the corporation derived no pecuniary benefit from the suit. In rejecting this contention, the *Neese* court placed Indiana squarely among those jurisdictions that have extended the "common benefit" rule for awarding fees and expenses for cases such as: where a fund was brought within the court's control; where a fund was established from which others would benefit although without the court's control;¹⁶ and where the derivative action has produced a nonpecuniary benefit for the corporation.¹⁷

The court in *Neese* relied upon and quoted substantially from the United States Supreme Court opinion in *Mills v. Electric Auto-Lite Co.*¹⁸ to reach this result. In *Mills*, the Court affirmed an interim award of litigation expenses and reasonable fees to plaintiffs in a derivative action challenging a corporate merger under section 14(a) of the Securities Exchange Act of 1934.¹⁹ To a certain extent, *Mills* recognized a second theory for awarding fees in a derivative action. The Court stated at one point that "the stress placed by Congress on the importance of fair and informed corporate suffrage leads to the conclusion that, in vindicating the statutory policy, petitioners have rendered a substantial service to the corporation and its shareholders."²⁰ This

COLUM. L. REV. 1 (1947); Hornstein, *Legal Therapeutics: The "Salvage" Factor in Counsel Fee Awards*, 69 HARV. L. REV. 658 (1956). See also other authorities cited in W. CARY & M. EISENBERG, CASES AND MATERIALS ON CORPORATIONS 942-43 (5th ed. unabr. 1980).

¹⁵428 N.E.2d at 39.

¹⁶See, e.g., *Sprague v. Ticonic Nat'l Bank*, 307 U.S. 161 (1939).

¹⁷428 N.E.2d at 39-40. See generally W. CARY & M. EISENBERG, *supra* note 14, at 939.

¹⁸396 U.S. 375 (1970).

¹⁹15 U.S.C. § 78n(a) (1976). There is an ironic ending to *Mills*. As noted, the fees upheld by the Court were interim fees. On remand, the district court awarded damages and prejudgment interest to the plaintiffs, but on appeal the Seventh Circuit found that the terms of the challenged merger were fair; thus, the plaintiffs could recover nothing and were not entitled to fees and expenses incurred subsequent to their victory in the Supreme Court. *Mills v. Electric Auto-Lite Co.*, 552 F.2d 1239, 1249-50 (7th Cir.), *cert. denied*, 434 U.S. 922 (1977). The court relied on *Alyeska* in denying fees and expenses. 552 F.2d at 1238. The plaintiffs who had won the battle thus lost the war, and those who continued the fight following the Supreme Court's decision were left to their own devices and pocketbooks. The Seventh Circuit is not totally "heartless" and recently awarded a fee of \$27,900 to an outside attorney who had done some work on *Mills* while it was before the Supreme Court. *Mills v. Electra Corp.*, 663 F.2d 760 (7th Cir. 1981) (attorney requested \$500,000).

²⁰396 U.S. at 396 (emphasis added).

second theory is that fees can be awarded where the plaintiffs were in effect "private attorney generals" helping to enforce the federal securities laws.²¹ In *Alyeska Pipeline Co. v. Wilderness Society*,²² however, the Court specifically rejected the private attorney general theory of awarding attorney fees in suits brought under federal statutes unless provided by specific statutory authorization. The Court in *Mills* did emphasize that benefits were conferred on the other shareholders by plaintiffs' suit; therefore, the *Mills* decision, which on its face is based on the common benefit theory, survives *Alyeska*.²³

As the court in *Neese* recognized, fees and expenses cannot be awarded to a plaintiff in all instances where defendants have done "some wrong," for to do so would invite the nuisance strike suit.²⁴ Such an award is only proper where the corporation receives a substantial benefit which "'maintain[s] the health of the corporation and raise[s] the standards of 'fiduciary relationships and of other economic behavior'" or which 'corrects or prevents an abuse which would be prejudicial to the rights and interests of the corporation or affect[s] the enjoyment or protection of an essential right to the stockholder's interest.'"²⁵

A court must establish a balance between the interests of the corporation and the interests of the minority shareholders. To award fees where there have been only insignificant wrongs would be unjust to the corporation, but to deny fees unless the corporation received some economic or monetary benefit could effectively foreclose minority shareholders from bringing derivative actions to correct improper corporate conduct.²⁶ The *Neese* court was satisfied that the corporation had received a substantial nonpecuniary benefit.²⁷ Albeit unlikely, the failure to keep correct and complete financial books and records could have subjected the corporation to fines.²⁸ Thus, the independent accounting ordered by the court improved the "health" of the cor-

²¹The concept of the private attorney general in part implies a cause of action for a violation of the SEC's proxy rules. See *J.I. Case Co. v. Borak*, 377 U.S. 426 (1964).

²²421 U.S. 240 (1975).

²³The philosophical attitude of the Court to securities' suits had changed from 1970 to 1975, and although *Alyeska* cited *Mills* with approval, as Professors Cary and Eisenberg point out, it is open to question whether the Court would again go as far as it did in *Mills* in determining what constitutes a benefit for purposes of awarding fees under the common fund theory. W. CARY & M. EISENBERG, *supra* note 14, at 939.

²⁴428 N.E.2d at 42.

²⁵*Id.* (quoting *Bosch v. Meeker Coop. Light & Power Ass'n*, 257 Minn. 362, 364-67, 101 N.W.2d 423, 426-27 (1960)).

²⁶428 N.E.2d at 42.

²⁷*Id.*

²⁸A corporation that fails to do any act required by the Indiana General Corporations Act commits a Class B infraction, subjecting it to a possible fine. IND. CODE §§ 23-1-10-1(a), 34-4-32-4(b) (1982).

poration by bringing it in line with the requirements of the General Corporation Act.²⁹

Neese is a caveat to anyone controlling a closely held corporation who might be taking, or be tempted to take, "slight" advantage of minority shareholders. No longer can a majority shareholder test the line between the rightful exercise of control and the abuse of minority shareholder interests with the notion that the minority shareholders are unlikely to balk, that is, sue, because it would not be worth their financial while. Now, such majority shareholders must keep in mind that improper conduct, even though not fraudulent, can result in fees and expenses being assessed to the corporation. This decision means they *will* pay something for their misdeeds.

B. Creation of Limited Partnerships

Perhaps the most interesting thing about the Indiana Uniform Limited Partnership Act (I.U.L.P.A.)³⁰ is that the relevant, reported cases interpreting the I.U.L.P.A. are decided by courts in other jurisdictions.³¹ The decision of the Illinois Appellate Court in *Allen v. Amber Manor Apartments Partnership*³² is such a case. In *Allen*, the court of appeals reversed the trial court's grant of plaintiff Allen's motion for partial summary judgment in an action to determine if Allen was a limited partner in an Indiana limited partnership that owned an apartment complex in Hobart, Indiana.³³

The *Allen* court held that summary judgment was precluded in this case, because there were factual issues as to whether the parties intended to form a limited partnership and, if so, when the limited partnership was formed.³⁴ Allen became involved in the project in late 1974, when he and other investors entered into an agreement to contribute \$500,000 to the capital of the partnership.³⁵ The term "capital" is used advisedly because the agreement provided that the payments,

²⁹428 N.E.2d at 43. Although not in issue in *Neese*, Professors Cary and Eisenberg briefly describe the methods for determining fees in a successful shareholder derivative suit. W. CARY & M. EISENBERG, *supra* note 14, at 940-41; see also Mowrey, *Attorney Fees in Securities Class Action and Derivative Suits*, 3 J. CORP. L. 267 (1978). It is likely that the value of the attorney's time rather than the value of the benefit produced will be emphasized in cases involving nonpecuniary benefits because of the difficulty of quantifying such benefits. *Id.* at 316-19.

³⁰IND. CODE §§ 23-4-2-1 to -31 (1982).

³¹See, e.g., *Plaza Realty Investors v. Bailey*, 484 F. Supp. 335 (S.D.N.Y. 1979), discussed in Galanti, *Business Associations, 1980 Survey of Recent Developments in Indiana Law*, 14 IND. L. REV. 91, 101-08 (1981).

³²95 Ill. App. 3d 541, 420 N.E.2d 440 (1981).

³³*Id.* at 552, 420 N.E.2d at 448.

³⁴*Id.* at 551, 420 N.E.2d at 448.

³⁵*Id.* at 543, 420 N.E.2d at 442.

which included a loan of \$50,000 to the general partners, were to be evidenced by promissory notes.³⁶ The agreement further provided that the purported capital contributions were due and payable within thirty days following notice of the completion of the project, which notice had to be given between June 15, 1975, and January 31, 1976.³⁷

The limited partnership is a noncorporate form of business enterprise that permits persons who are limited partners to invest money without the risk of unlimited liability, which risk persons who are general partners encounter. To achieve this limited liability status, however, the limited partner must place his contribution to capital at risk.³⁸ The *Allen* court found that the contribution made by a limited partner is "limited to the contribution made by a limited partner *at the time of formation* of the partnership for the benefit of the partnership's creditors."³⁹ This finding does not mean that the actual payment has to be made in toto at the time of the formation of the partnership. Rather, it requires an absolute commitment to contribute capital to the venture and to place that contribution at risk.⁴⁰ Of course, as a general matter, this contribution is made at the outset to finance the venture. Because the limited partner's investment must be at risk, it is improper for a limited partner to take collateral to secure repayment of his investment or to guarantee a return to himself.⁴¹

A limited partnership, like a general partnership, is a contractual relationship to which contract law principles apply, subject to the formal requirements of the I.U.L.P.A. The *Allen* court recognized this truism⁴² and then further recognized that an agreement, in and of itself, will not create a partnership unless the agreement reflects the parties' mutual assent to the terms of the agreement.⁴³ Failure to agree to or to discuss an essential term of a contract may be evidence that the requisite mutual assent was lacking and that no partnership, or at least no limited partnership, in fact had been formed.

³⁶*Id.* at 543-44, 420 N.E.2d at 442-43.

³⁷*Id.* at 543-44, 420 N.E.2d at 443. This agreement also provided that the new limited partners were to be admitted to the partnership as of January 1, 1974, and specified the parties' participation in the profits and losses of the venture. *Id.*

³⁸*Id.* at 547, 420 N.E.2d at 445. See *Kramer v. McDonald's System, Inc.*, 77 Ill. 2d 323, 396 N.E.2d 504 (1979).

³⁹95 Ill. App. 3d at 547, 420 N.E.2d at 445 (emphasis added).

⁴⁰The I.U.L.P.A. provides that a limited partner is liable to the partnership: "(a) For the difference between his contribution as actually made and that stated in the certificate as having been made, and (b) for any unpaid contribution which he agreed in the certificate to make in the future at the time and on the conditions stated in the certificate." IND. CODE § 23-4-2-17 (1982).

⁴¹IND. CODE § 23-4-2-16(1) (1982).

⁴²95 Ill. App. 3d at 549, 420 N.E.2d at 446.

⁴³*Id.*

The Illinois Appellate Court concluded that there was a factual issue as to whether a partnership, in fact, had been created.⁴⁴ Defendants' position was that Allen's interests, if any, depended on the project's completion by January 31, 1976. Allen's position was that his status as a limited partner did not depend on the completion date of the project. Thus, there was a major factual issue as to whether the parties contemplated the formation of the limited partnership to occur at the time the agreement was executed or when the project was completed.⁴⁵

It is obvious that the court was not particularly sympathetic to Allen's position because it observed that Allen's interpretation of the agreement would give him the status of a limited partner while not putting his investment at risk.⁴⁶ Under Allen's approach, Allen *could* escape all liability if the project was not completed before January 1, 1976, which was when his obligation to contribute ended.⁴⁷ Defendants, on the other hand, argued that no limited partnership could be formed because Allen had not made a capital contribution. These differing interpretations of the agreement meant that there were triable issues, and thus summary judgment was inappropriate.⁴⁸

The decision in *Allen* emphasizes that care is needed in drafting partnership documents to ensure that the intentions of the parties purporting to create a limited partnership are specified clearly and that there is agreement on all the pertinent elements of the relationship. The intriguing question left unanswered by the *Allen* court was that if Allen had not entered into a limited partnership, what was the relationship among the parties? Presumably, Allen would be a general partner subject to unlimited liability as a member of "an association of two or more persons to carry on as co-owners a business for profit," which is the definition of a partnership under the Indiana Uniform Partnership Act.⁴⁹ Although the opinion in *Allen* does not point out the context in which the litigation arose, it is distinctly possible that the project had failed and there was potentially unlimited liability. This would explain why Allen was attempting to obtain a determination that he was a limited partner and why the partnership and the individual general partners were appealing. If Allen was a

⁴⁴*Id.* at 551, 420 N.E.2d at 448.

⁴⁵*Id.* at 549-50, 420 N.E.2d at 447.

⁴⁶*Id.* at 550, 420 N.E.2d at 447.

⁴⁷*Id.* at 549, 420 N.E.2d at 447.

⁴⁸The court was also unable to determine if the \$50,000 the new limited partners advanced to the enterprise was a loan or a contribution to the capital. It observed that it was just as reasonable to infer that the money was intended as a loan as it was to infer that it was intended as a secured capital contribution which would contravene the I.U.L.P.A. 95 Ill. App. 3d at 550-51, 420 N.E.2d at 447-48.

⁴⁹IND. CODE § 23-4-1-6(1) (1982).

general partner, the individual general partners would have the right of indemnification provided for by section 23-4-1-18(b) of the Indiana Uniform Partnership Act.⁵⁰

One point in *Allen* that is worthy of note was the court's statement that the pleadings "contain a reference that due to some failure to comply with formal requisites of Indiana partnership law . . . [three individuals] became general partners."⁵¹ These individuals entered the venture after the partnership was formed, purportedly as limited partners. Presumably, when these three individuals were admitted to the partnership, the partnership failed to comply with the I.U.L.P.A. requirement that when an additional limited partner is admitted,⁵² an amended limited partnership certificate must be filed for record in the office of the recorder of the county where the partnership's principal place of business is located.⁵³

The reason for this filing requirement is obvious. The purpose for the certificate of partnership is to give notice to third persons of the essential features of the limited partnership;⁵⁴ the purpose for the amended certificate is to ensure that public information of record is current and up to date.⁵⁵ The failure to file an amended certificate in *Allen* meant that, potentially, the three individuals were subject to unlimited liability as general partners.⁵⁶

This aspect of *Allen* is not significant to the actual case, but it should remind attorneys representing limited partnerships to ensure that all statutory requirements are satisfied to avoid the very undesirable consequence of unlimited liability to persons believing themselves to be limited partners.

C. Securities Act—Receiver

The authority of the Indiana Securities Commissioner to seek a court-appointed receiver was clarified in *State ex rel. Higbie v. Porter Circuit Court*.⁵⁷ In *Higbie*, the judgment creditors of an attorney and

⁵⁰*Id.* at § 23-4-1-18(b). See generally J. CRANE & A. BROMBERG, PARTNERSHIP § 65(b) (1968).

⁵¹95 Ill. App. 3d at 542 n.1, 420 N.E.2d at 442 n.1.

⁵²IND. CODE §§ 23-4-2-8, -24(2)(c) (1982).

⁵³*Id.* at § 23-4-2-25(5). It is possible, however, that the problem was with the form of the amended certificate because the court does note that an amended limited partnership certificate was filed with the Lake County Recorder on December 30, 1974. 95 Ill. App. 3d at 545, 420 N.E.2d at 444.

⁵⁴See *Klein v. Weiss*, 284 Md. 36, 395 A.2d 126 (1978).

⁵⁵*Id.* at 62, 395 A.2d at 141.

⁵⁶Of course, if they claimed they erroneously believed themselves to be limited partners, then they could escape unlimited liability by renouncing their interests in the profits of the business or other compensation by way of income. IND. CODE § 23-4-2-11 (1982). However, the liability of these three individuals was not in issue in *Allen*.

⁵⁷428 N.E.2d 782 (Ind. 1981).

an accountant had been thwarted in their efforts to satisfy a judgment because of a court order appointing a receiver for the debtors. It appears that in a prior action the Indiana Securities Commissioner had successfully prosecuted a suit against the debtors, charging them with violating the Indiana Securities Act.⁵⁸ As a result of this suit, the Porter Circuit Court had appointed a receiver for the debtors, individually and as partners, to prevent the debtors from “dissipating, wasting, transferring or otherwise disposing of *their* assets absent the consent of such conservator or receiver or as a result of an appropriate order to this court following a hearing to that end.”⁵⁹

In an original action before the supreme court, the judgment creditors contended that the Porter Circuit Court had no jurisdiction to appoint a receiver for the assets of the individual debtors because there was no lien upon such assets in favor of the Indiana Securities Commissioner who had sought the receivership.⁶⁰

The circuit court’s contention, which was accepted by the Indiana Supreme Court, was that, even though the Securities Commissioner was not a creditor, he had authority to apply for a receiver, and that the circuit court had proper jurisdiction, pursuant to section 23-2-1-17.1(a) of the Indiana Securities Act. This provision authorizes the Securities Commissioner to issue cease and desist orders against persons violating the Indiana Securities Act and further authorizes that he may “bring action in the name and on behalf of the State of Indiana . . . to enjoin that person from continuing or doing any act furthering a violation of this chapter and may obtain the appointment of a receiver or conservator.”⁶¹

The Indiana Supreme Court construed section 23-2-1-17.1(a) as authorizing the appointment of a receiver, once it is clear that a violation of the Securities Act has or is about to occur.⁶² The required showing of unlawful conduct serves the same legal function as a lien or an interest in property when a creditor seeks a receiver for a debtor,⁶³ because the violation establishes the state’s interest in the violators’ property, which has a nexus to their business conduct.

To require a lien before a receiver can be appointed would not only contradict the express statutory language of the Securities Act, but would also severely hamper the effective enforcement of the Securities Act. Seizing and preserving the assets of a violator would ensure “that justice be done between the violator and the investor, and that public confidence be maintained in the effectiveness of the

⁵⁸IND. CODE §§ 23-2-1-1 to -24 (1982).

⁵⁹428 N.E.2d at 783 (emphasis added).

⁶⁰*Id.* See *McKain v. Rigsby*, 250 Ind. 438, 237 N.E.2d 99 (1968).

⁶¹IND. CODE § 23-2-1-17.1(a) (1982).

⁶²428 N.E.2d at 783.

⁶³*Id.* at 784.

government regulation of the securities industry.”⁶⁴ It would not be at all surprising if persons engaging in improper securities transactions kept poor, if any, books and records and commingled individual assets with “business” assets. Construing section 23-2-17.1(a) restrictively, by permitting individual creditors access to individual assets before malefactors’ affairs are straightened out, would clearly thwart the interests that are to be protected by the Indiana Securities Act.

Section 23-2-1-17.1 of the Indiana Securities Act is patterned after and similar to section 408 of the Uniform Securities Act.⁶⁵ Although the language differs, both the Indiana Act and the Uniform Act clearly intend to authorize the appointment of a receiver where the receiver will facilitate enforcement of the act and will protect the interests of the investor.⁶⁶ In fact, the importance of a receiver in enforcing securities laws had led two commentators to posit that language such as “in addition to any other remedies” may be sufficient to infer statutory authority for the appointment of a receiver in securities cases in those states that do not expressly authorize the enforcement agency to do so.⁶⁷

Although the language of section 23-2-1-17.1 of the Indiana Securities Act appears, on its face, to be clear, the supreme court’s decision in *Higbie* resolves any doubts as to the Securities Commissioner’s authority to seek a receiver.

D. Indiana Takeover Offers Act

The Indiana Takeover Offers Act⁶⁸ was at issue before the Indiana Court of Appeals in *In re CTS Corp.*⁶⁹ Unlike most suits involving

⁶⁴*Id.*

⁶⁵UNIF. SECURITIES ACT § 408, 7A U.L.A. 663 (1958). The Indiana provision is taken in part from section 408, which pertains to injunctive relief, and in part from section 407, which authorizes the agency enforcing the Act to conduct investigations and issue subpoenas. *Id.* at 660.

⁶⁶Surprisingly, there are not many reported cases under the Uniform Securities Act or similar legislation involving the appointment of a receiver. See *Commonwealth v. Ramco Petroleum, Inc.*, 3 BLUE SKY L. REP. (CCH) ¶ 71,525 (Mass. Sup. Ct. 1980); *Commonwealth ex rel. Pennsylvania Sec. Comm’n v. Allamanda Inv. Co.*, 388 A.2d 1141 (Pa. Commw. Ct. 1978). Of course, authority for the appointment of a receiver does not automatically mean one will be appointed. See *Pennsylvania Sec. Comm’n v. Continental Mfg. Co.*, 465 Pa. 411, 350 A.2d 831 (1976) (proper to refuse to appoint a receiver where defendants agreed to cease questioned transactions until a final determination if such transactions constituted a sale of securities).

⁶⁷See 11C H. SOWARDS & N. HIRSCH, BUSINESS ORGANIZATIONS—BLUE SKY REGULATION § 10.05[2] (1982).

⁶⁸IND. CODE §§ 23-2-3.1-0.5 to -11 (1982). The Takeover Offers Act is discussed in Galanti, *Corporations, 1979 Survey of Recent Developments in Indiana Law*, 13 IND. L. REV. 133, 161-72 (1980).

⁶⁹428 N.E.2d 794 (Ind. Ct. App. 1981).

takeover statutes,⁷⁰ the litigation in *CTS* was not a challenge by a tender offeror who was frustrated by a state takeover act. Instead, *CTS* was an appeal by the target company, *CTS*, from a determination by the Indiana Securities Commissioner that the offeror, Dynamics Corporations of America (DCA), had not engaged in any act or practice violating the Takeover Offers Act.⁷¹ *CTS* contended that the Securities Commissioner's conclusion was not supported by the evidence and was contrary to law. In addition, *CTS* claimed that the Securities Commissioner had erred in refusing to reopen the record to receive additional evidence.⁷²

The Securities Commissioner initially issued an ex parte cease and desist order against DCA but vacated the order after the Seventh Circuit's decision in *City Investing Co. v. Simcox*,⁷³ which had held that ex parte orders were specifically prohibited by the Takeover Offers Act. Then, at a contested hearing, *CTS* sought to establish that a brokerage firm buying relatively large blocks of *CTS* stock for DCA was engaged in a creeping tender offer, which was in violation of the Takeover Offers Act. The Securities Commissioner rejected that contention and subsequently refused to reopen the proceeding to receive "newly discovered evidence" because it found that *CTS*'s evidence was cumulative and not "newly" discovered. Relying on the provisions of the Takeover Offers Act pertaining to appeals,⁷⁴ and the provisions of the Indiana Administrative Adjudication Act pertaining to the admission of newly discovered evidence,⁷⁵ the *CTS* court refused to reweigh the evidence and concluded that the Securities Commissioner did not err in denying *CTS*'s request to reopen the record.⁷⁶

On the issue of whether DCA had made a tender offer, the Securities Commissioner clearly had followed the approach taken in *City Investing* and had looked to cases under the Williams Act amend-

⁷⁰See, e.g., *City Investing Co. v. Simcox*, 476 F. Supp. 112 (S.D. Ind. 1979), *aff'd*, 633 F.2d 56 (7th Cir. 1980), *discussed in* Galanti, *supra* note 31, at 112-17; *In re City Investing Co.*, 411 N.E.2d 420 (Ind. Ct. App. 1980), *discussed in* Galanti, *Business Associations, 1981 Survey of Recent Developments in Indiana Law*, 15 IND. L. REV. 31, 39-47 (1982).

⁷¹428 N.E.2d at 795.

⁷²*Id.*

⁷³633 F.2d 56, 58 (7th Cir. 1980).

⁷⁴IND. CODE § 23-2-3.1-11 (1982). The court actually referred to section 23-2-3-11 in the Indiana Business Takeover Act; however, that provision was repealed when the Indiana Takeover Offers Act was enacted in 1979 and before DCA started acquiring *CTS* shares. 428 N.E.2d at 802.

⁷⁵IND. CODE § 4-22-1-15 (1982). The evidence must be discovered after the hearing. Also, there is a presumption that newly discovered evidence might have been discovered in time to be used at trial. See *Shaw v. Shaw*, 159 Ind. App. 33, 304 N.E.2d 536 (1973); *Kelly v. Bunch*, 153 Ind. App. 407, 287 N.E.2d 586 (1972).

⁷⁶428 N.E.2d at 802.

ments to the Securities Exchange Act of 1934⁷⁷ to determine what constituted a tender offer. The courts in the Williams Act cases have looked at eight factors, which focus on the presence or absence of the substantive evils that the Williams Act was intended to prevent, in order to decide whether a tender offer has been made. The primary evil seems to be pressuring shareholders to make uninformed, ill considered decisions to tender their shares.⁷⁸

Although some courts⁷⁹ and commentators⁸⁰ have criticized this approach, it was accepted in *City Investing*. Thus, on appeal, the court in *CTS* was not willing to disturb the Securities Commissioner's finding that five of the eight commonly used criteria indicated there was no tender offer and that these five factors outweighed the three factors which tended to show there was a tender offer.⁸¹

Although not argued by the parties, the *CTS* court observed that the Securities Commissioner could have relied on sections 23-2-3-1(i)(1) and (6), which give him the discretion to determine that certain acquisitions did not constitute takeover offers.⁸² Presumably, these provisions were not argued because they were repealed in 1979 when the current Indiana Takeover Offers Act was adopted, and there are no comparable provisions in the current Takeover Offers Act. Also, the offeror had not acquired *CTS* shares until after the previous Takeover Offers Act was repealed.

Of course, the most interesting aspect of the Takeover Offers Act that was not considered by the *CTS* court was its constitutionality. The Takeover Offers Act had been upheld in *City Investing Co. v. Simcox*,⁸³ but the recent decision of the United States Supreme Court in *Edgar v. Mite Corp.*⁸⁴ raises considerable doubt as to the viability of the Indiana Act as well as to similar statutes in other states. The Court in *Edgar* held that the Illinois Business Takeover Act⁸⁵ was un-

⁷⁷15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1976).

⁷⁸428 N.E.2d at 799-800. See generally Note, *The Developing Meaning of "Tender Offer" Under the Securities Exchange Act of 1934*, 86 HARV. L. REV. 1250 (1973).

⁷⁹428 N.E.2d at 800. See, e.g., *Brscan Ltd. v. Edper Equities Ltd.*, 477 F. Supp. 773 (S.D.N.Y. 1979).

⁸⁰See Note, *Private Solicitations Under the Williams Act*, 66 CORNELL L. REV. 361 (1981).

⁸¹428 N.E.2d at 801. The court was unwilling to disturb the Securities Commissioner's decision because it was supported by the evidence, see *City of Mishawaka v. Stewart*, 261 Ind. 670, 310 N.E.2d 65 (1974), and because it is inappropriate for a court to substitute its judgment for that of the Securities Commissioner who is charged with enforcing the Takeover Offers Act. See *Department of Financial Inst. v. Colonial Bank & Trust Co.*, 176 Ind. App. 368, 375 N.E.2d 285 (1978).

⁸²428 N.E.2d at 798 n.2.

⁸³476 F. Supp. 112 (S.D. Ind. 1979), *aff'd*, 633 F.2d 56 (7th Cir. 1980).

⁸⁴102 S. Ct. 2629 (1982).

⁸⁵The Illinois Business Take-Over Act, ILL. REV. STAT. ch. 121½, ¶¶ 137.51 to .70 (Supp. 1982).

constitutional because it imposed an undue burden on interstate commerce.⁸⁶

It is, of course, possible that state takeover statutes can be drafted so that the statute will not impose a "substantial burden" on interstate commerce, but it may not be worthwhile. For example, the Takeover Offers Act currently exempts from the filing requirements⁸⁷ "an acquisition of equity securities of a target company having seventy-five (75) or fewer holders of record of equity securities at the time of the takeover offer."⁸⁸ If a state can regulate only tender offers for corporations in which the majority of shareholders are residents, it is interesting to wonder how many Indiana corporations exist with more than seventy-five shareholders, most of whom live in this state.

E. Corporate Service of Process

A financing corporation's attempt to insulate itself from the judicial process failed in *General Finance Corp. v. Skinner*,⁸⁹ a suit to recover benefits under a credit disability insurance policy that was purchased by the plaintiff, Skinner, when she refinanced a loan from General Finance Corporation of Indiana (GFC of Indiana), a subsidiary of the defendant, General Finance Corporation (GFC). In *Skinner*, GFC appealed from the Vigo Superior Court's denial of GFC's motion for relief from a default judgment. The motion had alleged insufficient service of process. A summons and complaint against GFC had been served by registered mail addressed to CT Corporation Systems, which was the agent of GFC of Indiana but not GFC's resident agent.⁹⁰ In other words, the subsidiary which had made the loan was served, but not the parent corporation which was being sued.

In *Skinner*, the court of appeals upheld the service on GFC, thus joining those jurisdictions which recognize that in appropriate circumstances the separate corporate existence of parent and subsidiary will be ignored, and service of process on one will be sufficient to acquire jurisdiction over an out-of-state parent or subsidiary.⁹¹ The effectiveness of service of process on one corporation in obtaining

⁸⁶102 S. Ct. at 2643.

⁸⁷IND. CODE §§ 23-2-3.1-3 to -5 (1982).

⁸⁸*Id.* at § 23-2-3.1-8.6(a)(3).

⁸⁹426 N.E.2d 77 (Ind. Ct. App. 1981).

⁹⁰426 N.E.2d at 79.

⁹¹*See* authorities cited 426 N.E.2d at 84. *See also* *Frazier v. Alabama Motor Club, Inc.*, 349 F.2d 456 (5th Cir. 1965); *Empire Steel Corp. v. Superior Court*, 56 Cal. 2d 823, 366 P.2d 502 (1961); *Taca Int'l Airlines S.A. v. Rolls Royce Ltd.*, 15 N.Y.2d 97, 256 N.Y.S.2d 129, 204 N.E.2d 329 (1965); *Comprehensive Sports Planning, Inc. v. Pleasant Valley Country Club*, 73 Misc. 2d 477, 341 N.Y.S.2d 914 (1973). *See generally* Wellborn, *Subsidiary Corporations in New York: When is Mere Ownership Enough to Establish Jurisdiction over the Parent*, 22 BUFFALO L. REV. 681 (1973).

jurisdiction over a parent or subsidiary depends on whether the affairs of the affiliated corporations are so commingled as to make the two impossible to separate; however, service of process on one will not suffice to obtain jurisdiction over the other, if their affairs are kept separate.⁹²

The mere fact that GFC of Indiana is a wholly owned subsidiary of GFC does not support jurisdiction over the parent by service on the subsidiary, because similar names or common ownership of stock alone will not suffice.⁹³ However, as the *Skinner* court noted, the relationship between GFC and GFC of Indiana went further. The two corporations had common officers, and the corporate counsel for both GFC and GFC of Indiana was the same person.⁹⁴ More important to the conclusion that the two corporations were actually one was the evidence set forth by the court, which included: the loans initiated by GFC of Indiana and by other GFC subsidiaries in twenty-five states were made from a common checking account in a Chicago bank; employees of GFC of Indiana and other subsidiaries were paid from that account by GFC; a computer terminal transmitted transactions to the GFC home office in Illinois which did all the subsidiary's accounting; letterheads and telephone listings referred to General Finance Corporation rather than General Finance Corporation of Indiana; GFC's advertising emphasized over 400 General Finance and General Finance Corporation offices from coast to coast where one could deal with "friendly Bob Adams"; financing statements showed GFC as the secured party; and forty-five lawsuits brought in Vigo County to collect defaulted loans were filed in GFC's name.⁹⁵

The court was satisfied that although there were "two separate corporate entities on paper, only one commonly-owned enterprise" existed.⁹⁶ The separate existence of GFC of Indiana could be disregarded because it was so organized and controlled in its affairs that

⁹²See *Cannon Mfg. Co. v. Cudahy Packing Co.*, 267 U.S. 333 (1925). See also *Botwinick v. Credit Exchange, Inc.*, 419 Pa. 65, 213 A.2d 349 (1965) (activities of subsidiary which carefully maintained its separate corporate existence, not those out-of-state parent for purposes of service of process).

⁹³See *Botwinick v. Credit Exchange, Inc.*, 419 Pa. 65, 72, 213 A.2d 349, 353-54 (1965).

⁹⁴426 N.E.2d at 79. Normally common officers or directors will not warrant disregard of corporate existence. See *Merriman v. Standard Grocery Co.*, 143 Ind. App. 654, 242 N.E.2d 128 (1968). However, it is a factor to be considered.

The *Skinner* court noted that GFC is wholly owned by CNA Financial Corporation, a financial conglomerate which directly or indirectly controlled sixty or more other substantial corporations, and that CNA in turn was controlled by Loews Corporation. 426 N.E.2d at 79. The reason for this reference is unclear because the size of the overall enterprise is completely irrelevant in determining whether a parent and subsidiary are one and the same.

⁹⁵426 N.E.2d at 79-81.

⁹⁶*Id.* at 82.

it was, in effect, a division of GFC.⁹⁷ Consequently, service on the registered agent of GFC of Indiana was service on a lawfully appointed agent of GFC within the meaning of Indiana Trial Rule 4.6(A)(1);⁹⁸ therefore, the entry of a default judgment against GFC was appropriate. Although default judgments are not favored because they are rendered without trial, a trial court has considerable discretion in this area, and a default judgment will be reversed only upon a showing of a clear abuse of discretion.⁹⁹ Certainly, a person is entitled to have a default judgment set aside if he has not been served with process and thus had no notice of the proceeding,¹⁰⁰ but GFC did have notice.¹⁰¹

The *Skinner* result is obviously correct. If the parent and subsidiary are held separate, service on one should not be service on the other. If, however, a large enterprise structures its operations through myriad subsidiaries in a "complex and interrelated manner so as to prevent ascertainment of exactly which corporate entity"¹⁰² is responsible, the corporation should not be surprised if the corporate fiction is ignored and service on one "part" of the enterprise is deemed service on another part.¹⁰³ A business enterprise that is deliberately set up in a complex fashion should not expect the public with whom it deals to wend through a corporate labyrinth at their peril if they should happen to select the wrong "path."

F. Buy-Sell Agreements and Irrevocable Proxies

Attorneys representing small, closely held corporations should note

⁹⁷See *Merriman v. Standard Grocery Co.*, 143 Ind. App. 654, 242 N.E.2d 128 (1968); *Feucht v. Real Silk Hosiery Mills, Inc.*, 105 Ind. App. 405, 12 N.E.2d 1019 (1938).

⁹⁸IND. R. TR. P. 4.6(A)(1). *Skinner* did not have to serve the Indiana Secretary of State, as the acting agent for GFC as a foreign corporation not admitted to do business, pursuant to IND. CODE § 23-3-3-1 (1982), because an actual agent of GFC was served. Thus, the constitutionally imposed requirement that service reasonably inform the parties of the nature of the proceeding was satisfied, even though the return of the summons and complaint by GFC of Indiana's registered agent did in fact, as GFC argued, notify *Skinner* that an alternative method of service could have been utilized.

⁹⁹See *Erdman v. White*, 411 N.E.2d 653 (Ind. Ct. App. 1980); *Green v. Karol*, 168 Ind. App. 467, 344 N.E.2d 106 (1976).

¹⁰⁰See *Keiling v. McIntire*, 408 N.E.2d 565 (Ind. Ct. App. 1980).

¹⁰¹426 N.E.2d at 86. On rehearing, the court emphasized that GFC and GFC of Indiana constituted only one entity. Since it was never disputed in *Skinner* that C.T. Corporation was the resident agent of GFC of Indiana, the court on rehearing also distinguished cases questioning whether the person served was an authorized agent. 431 N.E.2d 526 (Ind. Ct. App. 1982).

¹⁰²*Merriman v. Standard Grocery Co.*, 143 Ind. App. 654, 657, 242 N.E.2d 128, 130 (1968).

¹⁰³Courts are perhaps somewhat more inclined to disregard the corporate fiction when the issue is service of process than when the issue is imposing liability on, for example, a parent corporation for the torts or contracts of a subsidiary. See generally H. HENN, HANDBOOK OF THE LAW OF CORPORATIONS § 151 (2d ed. 1970).

Williams v. Williams (Williams II).¹⁰⁴ The court of appeals in *Williams II* affirmed a Boone Circuit Court order that denied plaintiff Mildred Williams' motion for preliminary injunction in an action brought against Howard Williams to compel him to call and to hold an annual meeting of W & W, Inc. Howard owned fifty percent of the shares of W & W, and Mildred's husband had owned the balance prior to his death.¹⁰⁵ The shares were subject to a buy-sell agreement that provided that W & W would purchase the shares of a deceased shareholder and that gave "the surviving natural party . . . a special power of attorney to vote such shares until the transfer [of stock to the corporation had been] completed."¹⁰⁶ Thus, the buy-sell agreement expressly stated that the surviving shareholder, rather than the personal representative of the deceased shareholder, should vote the stock until the transfer was completed.¹⁰⁷

The corporation eventually petitioned for an order directing Mildred, as executrix, to perform the buy-sell agreement. In that action, *In re Estate of Williams (Williams I)*,¹⁰⁸ Mildred prevailed because the claim was not filed within the time specified in the Indiana Probate Code. The court in *Williams I*, however, expressly acknowledged that under the probate code the buy-sell agreement could be enforced against the heirs or the devisees who succeeded to the decedent's interest in the shares.¹⁰⁹ Because the refusal to enforce the buy-sell agreement in *Williams I* was procedural and not on the merits, the *Williams II* court held that the present action was not barred under the doctrine of res judicata.¹¹⁰

Because the buy-sell agreement could still be enforced, the court noted that Mildred would not suffer irreparable harm if a preliminary injunction ordering a shareholders' meeting was denied. Although Mildred owned fifty percent of the corporation's stock, the buy-sell agreement gave Howard a proxy to vote Mildred's shares, so that, even if Howard called a meeting of W & W shareholders, he could vote her shares. Therefore, an order compelling Howard to call a meeting would be a futile gesture. There was no problem with the duration of the proxy exceeding eleven months because the proxy

¹⁰⁴427 N.E.2d 727 (Ind. Ct. App. 1981). For further discussion of this case, see Falender, *Trusts and Decedents' Estates, 1982 Survey of Recent Developments in Indiana Law*, 16 IND. L. REV. 415, 419 (1983).

¹⁰⁵427 N.E.2d at 728-29.

¹⁰⁶*Id.* at 728.

¹⁰⁷*Id.*

¹⁰⁸398 N.E.2d 1368 (Ind. Ct. App. 1980), discussed in Falender, *Decedents' Estates and Trusts, 1980 Survey of Recent Developments in Indiana Law*, 14 IND. L. REV. 291, 298-301 (1981).

¹⁰⁹427 N.E.2d at 729 (citing *In re Estate of Williams*, 398 N.E.2d at 1371).

¹¹⁰427 N.E.2d at 730-31.

was in writing and complied with the Indiana General Corporation Act.¹¹¹ Furthermore, the proxy was irrevocable as a result of the buy-sell agreement which gave Howard an interest in the shares.¹¹²

Of course, it is possible that the dispute has not yet been resolved. Mildred contended that the buy-sell agreement was merely an option to sell and that W & W had an obligation to purchase only if she chose to sell; whereas, W & W and Howard claimed that the buy-sell agreement provided that Mildred had a duty to sell. The court noted that the proper construction of the buy-sell agreement was not in issue before the court.¹¹³ Thus, it is possible that we may see *Williams III*.¹¹⁴

G. Definitions of a Security

A case involving securities regulation that is worthy of note is *Canfield v. Rapp & Son, Inc.*,¹¹⁵ in which the Court of Appeals for the Seventh Circuit affirmed a judgment of the District Court for the Southern District of Indiana. The district court held that Rapp had failed to establish any of the material elements for recovery under either federal or state securities law or common law fraud.¹¹⁶ The essential issue on appeal was whether Rapp's purchase of all shares of Twigg Corporation from Canfield and two others was a sale of a "security" within the meaning of the securities laws. Relying on its earlier decision in *Frederiksen v. Poloway*,¹¹⁷ the appellate court held that the purchase of the shares ancillary to the acquisition and assumption of control of Twigg was not a transaction involving "securities" and, therefore, could not give rise to a cause of action under any of the following statutory laws:¹¹⁸ rule 10b-5¹¹⁹ promulgated under the

¹¹¹IND. CODE § 23-1-2-9(e) (1982).

¹¹²427 N.E.2d at 731. See *State ex rel. Breger v. Rusche*, 219 Ind. 559, 39 N.E.2d 433 (1942). See also *Calumet Indus., Inc. v. MacClure*, 464 F. Supp. 19 (N.D. Ill. 1978) (determining the irrevocability of consent agreements by comparing them with proxy arrangements). See generally 5 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 2062 (rev. perm. ed. 1976 & Supp. 1982).

¹¹³427 N.E.2d at 730 n.2.

¹¹⁴*Williams I* and *Williams II* appear to be examples of the all too common family disputes involving closely held corporations, which are a bane to families but a boon to attorneys. For an example of this problem, see *Galler v. Galler*, 45 Ill. App. 2d 452, 196 N.E.2d 5, *aff'd in part, rev'd in part*, 32 Ill. 2d 16, 203 N.E.2d 577 (1964), *appeal dismissed*, 69 Ill. App. 2d 397, 217 N.E.2d 111 (1966), *appeal on other grounds, aff'd*, 95 Ill. App. 2d 340, 238 N.E.2d 274 (1968), *modified upon denial reh'g*, 21 Ill. App. 3d 811, 316 N.E.2d 114 (1974), *aff'd*, 61 Ill. 2d 464, 336 N.E.2d 886 (1975).

¹¹⁵654 F.2d 459 (7th Cir. 1981).

¹¹⁶*Id.* at 460.

¹¹⁷637 F.2d 1147 (7th Cir.), *cert. denied*, 451 U.S. 1017 (1981).

¹¹⁸654 F.2d at 462-63.

¹¹⁹17 C.F.R. § 240.10b-5 (1982).

Securities Exchange Act of 1934;¹²⁰ section 17(a) of the Securities Act of 1933;¹²¹ or the anti-fraud provision of the Indiana Securities Law.¹²² This result was reached notwithstanding the fact that the transaction was a "stock sale" within the literal meaning of the term "security" as defined in the three statutes.¹²³ The appellate court found that, in essence, the transaction was a commercial purchase and sale of Twigg that was effectuated through the purchase of shares, which served only as an indicia of ownership.¹²⁴

The underlying rationale for *Canfield* and *Frederiksen* is the Seventh Circuit's interpretation of the United States Supreme Court decision in *United Housing Foundation, Inc. v. Forman*.¹²⁵ The Seventh Circuit reads *Forman* as imposing an economic reality test in deciding when a particular "instrument" is a security. This test, according to the *Canfield* court, consists of three elements: (1) an investment in a common venture; (2) premised on a reasonable expectation of profit; (3) to be derived from the entrepreneurial or managerial efforts of others.¹²⁶ The court concluded that Rapp's purchase failed to satisfy the first element because there was no sharing or pooling of funds with others and also failed the third element because Rapp took over the management, control, and operation of Twigg.

Rapp attempted to distinguish *Frederiksen* on the ground that the economic reality test does not apply if a transaction involves "stock" with all the attributes of ordinary common stock. Rapp relied upon *Coffin v. Polishing Machines, Inc.*¹²⁷ in which the economic reality test was applied only after the court decided that the shares under consideration were not ordinary capital stock. Although there is language in *Forman* that the name given to an instrument is not wholly irrelevant to its status, the *Canfield* court rejected *Coffin* because of the

¹²⁰15 U.S.C. § 78j(b) (1976).

¹²¹*Id.* § 77q(a).

¹²²IND. CODE § 23-2-1-12 (1982).

¹²³The definition of the term "security" in the Securities Act of 1933, 15 U.S.C. § 77(b) (1976), the Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(10), and the Indiana Securities Act, IND. CODE § 23-2-1-1(k) (1982) are functionally equivalent. See *American Fletcher Mortgage Co. v. U.S. Steel Credit Corp.*, 635 F.2d 1247 (7th Cir. 1980), *cert. denied*, 451 U.S. 911 (1981).

¹²⁴654 F.2d at 463.

¹²⁵421 U.S. 837 (1975) ("shares of stock" necessary to obtain subsidized low income housing, which shares could not be pledged or encumbered and did not possess voting rights, and which in effect represented a tenant's deposit not securities within the meaning of the federal securities laws).

¹²⁶654 F.2d at 463. This test is derived from *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946).

¹²⁷596 F.2d 1202 (4th Cir.), *cert. denied*, 444 U.S. 868 (1979). The court also refused to distinguish *Frederiksen* because in both *Canfield* and *Frederiksen* a business was purchased and the assets rather than the stock were sold.

necessity of looking beyond the form of the instrument to decide whether in reality it is a security.¹²⁸

However, in a 1982 decision, *Golden v. Garafalo*, a panel of the Court of Appeals for the Second Circuit expressly rejected the *Frederiksen* interpretation of *Forman* and held that the sale of all the stock of a corporation, even in connection with a transfer of business ownership, was a sale of a security.¹²⁹ The panel, like the court in *Coffin*, reasoned that the economic reality test was appropriate only when courts were considering “unusual or unique” instruments governed by the statutory phrase “investment contract.” An example of the “unusual or unique” would be the “stock” in the cooperative housing project involved in *Forman* or the unique, one on one, negotiated certificate of deposit which was held not to be a security in *Marine Bank v. Weaver*.¹³⁰ Thus, although the *Canfield-Frederiksen* sale of business doctrine has been relied upon in a growing number of cases,¹³¹ the *Golden* court was not willing to narrowly define the term “security” so that, in effect, the federal securities acts are substantially repealed.

One of the problems with the *Canfield-Frederiksen* approach is that it really goes beyond *Forman*. Although the Seventh Circuit’s position might reflect what appears to be the current hostility of the Supreme Court to the federal securities laws,¹³² there is a tendency to forget that the Supreme Court has recognized that the definition of security that is contained in the federal acts, and, in effect, the Indiana Securities Act, should be read broadly.¹³³ As the Second Cir-

¹²⁸654 F.2d at 464-65.

¹²⁹678 F.2d 1139 (2d Cir. 1982). Judge Lumbard, dissenting in *Golden*, took the position that the two-part approach of *Forman* was necessitated because there were alternative grounds for the Second Circuit’s holding that the cooperative apartment “stock” was a security. Consequently, Judge Lumbard thought that a finding that an instrument possesses the common characteristics of corporate stock does not foreclose an inquiry into the economic reality of the transaction. *Id.* at 1147 (Lumbard, J., dissenting).

¹³⁰455 U.S. 551 (1982).

¹³¹*See, e.g.,* *Reprosystem v. SCM Corp.*, 522 F. Supp. 1257 (S.D.N.Y. 1981); *Oakhill Cemetery of Hammond, Inc. v. Tri-State Bank*, 513 F. Supp. 885 (N.D. Ill. 1981); *Zilker v. Klein*, 510 F. Supp. 1070 (N.D. Ill. 1981); *Anchor-Darling Indus., Inc. v. Suozzo*, 510 F. Supp. 659 (E.D. Pa. 1981); *Barsy v. Verin*, 508 F. Supp. 952 (N.D. Ill. 1981); *Dueker v. Turner*, [1979-1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,386 (N.D. Ga. 1979); *Bula v. Mansfield*, [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,964 (D. Colo. 1977); *Tech Resources, Inc. v. Estate of Hubbard*, 246 Ga. 583, 272 S.E.2d 314 (1980).

¹³²*See, 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); *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).

¹³³*See* *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298-99 (1946). There is even a tendency to forget that the “instruments” in *Howey*, which were maintenance agreements

cuit said in *Golden v. Garafalo*,¹³⁴ there would be little reason for the statutory drafters "to use words such as 'stock,' 'treasury stock' or 'voting—trust certificate,' unless their intention was to include all such instruments as commonly defined."¹³⁵ References to specific types of instruments and common variations would have been inappropriate if an economic reality test were intended to apply across the board, because many instruments would be excluded from these categories by a definition that looked only to economic reality. In fact, if economic reality were Congress's intent, there would be no reason to mention specific types of securities, and thus a general catch-all term such as "investment contracts" would have sufficed.¹³⁶ However, this issue was not discussed by the court in either *Canfield* or *Frederiksen*; in addition, the court, in both cases, simply rejected the "literal application" argument.¹³⁷

Another problem with the *Canfield-Frederiksen* doctrine is that, although many transactions involving corporate shares are not really securities cases, the doctrine goes too far and insulates transactions that are truly securities cases from scrutiny under the appropriate statutes enacted to protect investors. For example, in *Oakhill Cemetery of Hammond, Inc. v. Tri-State Bank*,¹³⁸ where a new manager had purchased a controlling block of stock but less than 100% of the outstanding shares, the federal district court used the doctrine to take the transaction outside the scope of the securities law.¹³⁹ *Oakhill* is consistent with *Canfield-Frederiksen* because the purchase was a "commercial" transaction to the manager and the purchaser was going to manage the enterprise. Therefore, the third element of the economic reality test could not be satisfied. Of course, this approach ignores the possibility that a purchaser of a business might regard himself

connected with the purchase of trees in a citrus grove, were found to be securities. *Id.* at 295, 299-300.

¹³⁴678 F.2d 1139 (2d Cir. 1982).

¹³⁵*Id.* at 1144.

¹³⁶*See id.*

¹³⁷*Canfield v. Rapp & Son, Inc.*, 654 F.2d 459, 465 (7th Cir. 1981); *Frederiksen v. Poloway*, 637 F.2d 1147, 1150-52 (7th Cir.), *cert. denied*, 451 U.S. 1017 (1981). *See generally* Comment, *Acquisition of Business through Purchase of Corporate Stock: An Argument for Exclusion from Federal Securities Regulation*, 8 FLA. ST. U.L. REV. 295 (1980).

¹³⁸513 F. Supp. 885 (N.D. Ill. 1981). The *Oakhill* approach is not without its supporters. *See generally* Seldin, *When Stock is not a Security: The "Sale of Business" Doctrine Under the Federal Securities Laws*, 37 BUS. LAW 637 (1982); Thompson, *The Shrinking Definition of a Security: Why Purchasing All of a Company's Stock is Not a Federal Security Transaction*, 57 N.Y.U. L. REV. 225 (1982).

¹³⁹513 F. Supp. at 888. *Oakhill* involved an alleged violation of the federal securities laws, Indiana common law, and, for some reason, a violation of the section of the Indiana Securities Act concerning the registration of brokers, investment advisors, and agents. *See* IND. CODE § 23-2-1-11 (1982).

both as an investor hoping to realize an appreciation in the stock, as well as an entrepreneur receiving compensation for operating the business.¹⁴⁰

The *Canfield-Frederiksen* approach also presents the potential anomalous result that “investors” may buy some of the stock of a business and hence would be entitled to protection under the securities laws, but if the managers buy the balance they would not be entitled to recover under the securities laws, although the managers may be just as defrauded as the former group. If the managers get a “free ride,” that is, the stock is a security because of the presence of the investors, then the entire concept behind the “sale of business” doctrine collapses. However, if it is found that the managers did not purchase “securities,” which the logical application of *Canfield-Frederiksen* would mandate, a grave injustice will result because they will be treated differently than their equally defrauded “investor” co-purchasers. After all, not everyone who purchases a business is in a position to protect their investment because they may not be knowledgeable about the business they are acquiring.¹⁴¹

Of course, the immediate answer is that anyone who has purchased a business as a result of fraud can always sue for fraud. But then again, in *Canfield*, Rapp sued for fraud and was unsuccessful because he had “failed to prove any of the essential elements of fraud—misrepresentation, scienter, reliance, causation, and damages.”¹⁴²

In *Canfield*, the Seventh Circuit purported to interpret the definition of a security in the Indiana Securities Act. The decision, however, is not binding on Indiana courts. One may hope that, when faced with the question whether a sale of a business effected through the sale of stock is subject to the Indiana Securities Act, an Indiana court would consider the reasoning of the majority opinion in *Golden*, and not simply accept the *Canfield-Frederiksen* sale of business doctrine as the proper interpretation of the law. Fraud is fraud, and if it can be prevented or deterred by the literal language of the Indiana Securities Act, the literal interpretation should be honored. Courts that adopt the sale of business doctrine appear to be judicially repealing the securities laws in the guise of interpreting them. If these statutes are not to apply to closely held corporations, or to situations

¹⁴⁰See *Golden v. Garafalo*, 678 F.2d 1139 (2d Cir. 1982).

¹⁴¹The ability of a purchaser of a company to protect his investment is often given as a reason for narrowly defining a “security.” See generally Hannan & Thomas, *The Importance of Economic Reality and Risk in Defining Federal Securities*, 25 HASTINGS L.J. 219 (1974).

¹⁴²654 F.2d at 466. The only evidence of “fraud” introduced by Rapp related to future events, and a fraud action requires statements of fact relating to existing or past events, not future events. See *Royal Business Mach., Inc. v. Lorraine Corp.*, 633 F.2d 34 (7th Cir. 1980).

where an entire business is purchased because the purchaser should be able to fend for himself, then it seems more appropriate for the legislature to decide that the statutes do not apply.¹⁴³

H. Statutory Developments

The first statutory development that would be of interest to those involved with business associations law during the survey period was the enactment of Public Law 142,¹⁴⁴ which amended section 23-1-2-11(h)¹⁴⁵ of the Indiana General Corporation Act. This section now permits the use of conference calls for board of directors' meetings or for meetings of committees designated by a corporate board, by providing that participation in a meeting by means of a conference telephone or similar communication equipment that allows all persons participating in the meeting to communicate with each other constitutes "presence in person at the meeting."¹⁴⁶ The power to hold such telephonic meetings, however, may be restricted or prohibited in a corporation's articles or bylaws.¹⁴⁷ Amended section 23-1-2-11(h) is similar to section 43 of the Model Business Corporation Act¹⁴⁸ and to the corporations acts of numerous states.¹⁴⁹

This is a worthwhile amendment to the Indiana General Corporation Act. As pointed out in the comment on a proposed amendment to section 43 of the Model Act, "[t]elecommunications equipment has been so improved that conference calls can be speedily arranged and amplifying facilities activated wherever there is need."¹⁵⁰ There is certainly no reason to deny the benefits of modern communication systems to boards of directors when so much of the ordinary business of corporations is carried on by such means. Furthermore, because the Indiana General Corporation Act specifically permits a board or committee to take action without a meeting, if prior written consent is given,¹⁵¹ it is senseless not to authorize the use of modern equipment to permit directors who are unable to attend a meeting in person to participate.

¹⁴³In some jurisdictions, this has been done. See, e.g., ILL. REV. STAT. ch. 121½, § 137.4(o) (1979).

¹⁴⁴Act of Feb. 24, 1982, Pub. L. No. 142, 1982 Ind. Acts 1050.

¹⁴⁵IND. CODE § 23-1-2-11(h) (1982).

¹⁴⁶*Id.*

¹⁴⁷*Id.*

¹⁴⁸MODEL BUSINESS CORP. ACT § 43 (2d ed. Supp. 1977) [hereinafter cited as MODEL ACT]. Section 43 was amended in 1974 to authorize conference calls. See *Changes in the Model Business Corporation Act*, 29 BUS. LAW. 947, 948 (1974).

¹⁴⁹See MODEL ACT, *supra* note 148, ¶ 3, at 338-41.

¹⁵⁰*Proposed Change in the Model Business Corporation Act Amending Section 43 to Permit the Holding of Meetings of Directors and Committees by Electronic Communication*, 28 BUS. LAW. 979, 980 (1973).

¹⁵¹IND. CODE § 23-1-2-11(i) (1982).

Many early cases striking down informal actions by directors¹⁵² were predicated on the theory that deliberative, collegial decision-making was the reason why the control and management of the affairs of a corporation were vested in the board of directors. The physical absence of the director also explains, to some extent, cases prohibiting directors from voting by proxy.¹⁵³ If the objective of a board meeting is to allow the interchange of ideas through group discussion and deliberation, then it is logical to authorize the use of modern technology which will, in fact, facilitate such collegial decisionmaking. Now directors who cannot physically attend meetings can "reach out" and participate.¹⁵⁴

Statutory authorization of telephonic meetings was probably necessary. There is always the possibility that any informal action which is not done in accordance with statutory provisions may be held invalid.¹⁵⁵ There is some common law authority that a director is *not* present at a meeting if he participates in the meeting by means of a telephone call because meeting means "the coming together of two or more persons face to face so as to be in each other's presence or company."¹⁵⁶

The General Assembly also amended Indiana insurance law to permit telephonic meetings of directors of Indiana insurance companies.¹⁵⁷ Interestingly, the General Assembly did not amend sec-

¹⁵²*See, e.g.*, Schuckman v. Rubenstein, 164 F.2d 952 (6th Cir. 1947), *cert. denied*, 333 U.S. 875 (1948); Baldwin v. Canfield, 26 Minn. 43, 1 N.W. 261 (1879); Audenried v. East Coast Milling Co., 68 N.J. Eq. 450, 59 A. 577 (1904). Of course, the general rule was often subject to the standard exceptions of estoppel, ratification, or acquiescence. *See generally* 1 G. HORNSTEIN, CORPORATION LAW & PRACTICE § 412, at 507-08 (1959).

¹⁵³*See, e.g.*, Dowdle v. Central Brick Co., 206 Ind. 242, 189 N.E. 145 (1934). *See also* Greenberg v. Harrison, 143 Conn. 519, 124 A.2d 216 (1956) (directors must give deliberative control and cannot vote by proxy); Lippman v. Kehoe Stenograph Co., 11 Del. Ch. 80, 95 A. 895 (1915) (the personal judgment of the director is important and he cannot vote by proxy).

¹⁵⁴This is particularly true in situations where the presence of a director is needed to satisfy quorum or voting requirements, or for a corporation with greater than normal quorum and voting requirements where the absence of a director may preclude speedy action, even though all directors are in agreement but the requisite consents cannot be signed prior to the action.

Of course, the use of electronic communications also will be helpful to large corporations with many widespread directors because the cost of equipment or user charges will be far less than the cost of transporting the directors to one meeting place.

¹⁵⁵*See* H. HENN, HANDBOOK OF THE LAW OF CORPORATIONS § 208 (2d ed. 1970).

¹⁵⁶*Re* Associated Color Laboratories, Ltd., [1970] 12 D.L.R. 3d 338, 343 (B.C. Sup. Ct. chambers).

¹⁵⁷Act of Feb. 18, 1982, Pub. L. No. 161, 1982 Ind. Acts 1219 (amending IND. CODE § 27-1-7-10(g) (1982)). This Act also added a new provision authorizing directors of insurance companies to act without meetings by means of prior written consents. *Id.* at 1221 (codified at IND. CODE § 27-1-7-10(h) (1982)). The language differs from the In-

tion 23-7-1.1-10 of the Indiana Not-for-Profit Corporation Act¹⁵⁸ to permit telephonic meetings of the directors of Indiana not-for-profit corporations. It is difficult to determine if this omission was deliberate or an oversight. Arguably, boards of not-for-profit corporations, or at least small ones such as neighborhood civic leagues, should meet in person to maintain the closeness of the organization. On the other hand, there seems to be no reason to deny the *right* to conduct telephonic meetings to not-for-profit corporations if the members so desire. The Not-for-Profit Corporation Act does permit informal action without a meeting by the use of consents,¹⁵⁹ and nothing would preclude restricting or prohibiting telephonic meetings in the articles or by-laws of a not-for-profit corporation.

Another significant enactment in the business area was Public Law 143,¹⁶⁰ which amended section 23-1-2-13 of the Indiana General Corporation Act¹⁶¹ by eliminating the prohibition against the same person performing the duties of the president and secretary of an Indiana general corporation. As the Act now stands, if the corporation's by-laws so provide, the same person can hold two or more offices in a corporation, including the office of president and the office of secretary. By eliminating the prohibition, the General Assembly brought the General Corporation Act in line with the three major Indiana professional corporation acts which have permitted the same person to serve as both president and a secretary of a professional corporation since 1973.¹⁶²

The prohibition was a particular problem for professional corporations because the acts prohibit nonprofessionals from serving as officers, directors, or shareholders. It does not necessarily follow, however, that permitting the same person to serve as both president and secretary of a general corporation is desirable. Admittedly, it appears that unless barred by statute, articles, or by-laws, the common law permitted a person to hold several corporate offices, including president and secretary.¹⁶³ Many statutes, however, including the

diana General Corporations Act, IND. CODE § 23-1-2-11(i) (1982), but the effect of the two provisions will be the same.

¹⁵⁸IND. CODE § 23-7-1.1-10 (1982).

¹⁵⁹*Id.*

¹⁶⁰Act of Feb. 24, 1982, Pub. L. No. 143, 1982 Ind. Acts 1054.

¹⁶¹IND. CODE § 23-1-2-13(a) (1982).

¹⁶²General Professional Corporation Act, IND. CODE §§ 23-1-13-1 to -12 (1982); Professional Medical Corporation Act, IND. CODE §§ 23-1-14-1 to -22 (1982); and the Professional Dental Corporation Act, IND. CODE §§ 23-1-15-1 to -22 (1982). *See generally* Galanti, *Corporations, 1973 Survey of Recent Developments in Indiana Law*, 7 IND. L. REV. 77, 109-12 (1973).

¹⁶³*See* *President & Directors of the Manhattan Co. v. Kaldenberg*, 165 N.Y. 1, 58 N.E. 790 (1900) (same person may simultaneously occupy the offices of president and de facto secretary and in such capacities may execute a document requiring authen-

Model Act,¹⁶⁴ prohibited this. There is no conceptual difficulty with one person wearing the proverbial “two hats,” but it probably is better to have two different individuals sign corporate documents or instruments, which have to be acknowledged or verified by two officers as an analogue to governmental checks and balances.

To some extent that rationale was undercut in 1981 when the General Assembly amended both Indiana corporation acts to permit “any current officer” to sign documents instead of requiring two signatures.¹⁶⁵ By reducing the role of the secretary, the General Assembly essentially eliminated any reason for having two individuals serve in the two capacities.

This development raises an interesting question—why require a corporation to have a secretary?¹⁶⁶ The General Assembly simply could eliminate the position and provide that any document, such as a resolution of the board of directors, could be certified by any officer.¹⁶⁷ If the Indiana General Corporation Act has eliminated the need for a secretary, the issue arises as to how persons in other states dealing with Indiana corporations will react to documents signed by the same person acting as both president and secretary, not to mention documents executed by only one officer. It is not inconceivable that Indiana attorneys may find themselves explaining Indiana law to nonresidents. Certainly this author would proceed with caution, if he were in another state and were presented with a corporate document that was executed by a person as president and attested to by the same individual as secretary. A likely concern would be whether the arrangement, in fact, was permitted under Indiana law.

Although there may be arguments against the trend, even a traditionalist such as this author must admit that the prolifera-

tion of the president and secretary). *See also* *Collins v. Tracy Grill & Bar Corp.*, 144 Pa. Super. 440, 19 A.2d 617 (1941). *See generally* 6 Z. CAVITCH, *BUSINESS ORGANIZATIONS* § 128.01 [2] (1982); 1 G. HORNSTEIN, *CORPORATION LAW & PRACTICE* § 512 (1959); 2 MODEL ACT, *supra* note 148, § 50, ¶ 3.02.

¹⁶⁴2 MODEL ACT, *supra* note 148, § 50. Section 18 of the proposed Statutory Closed Corporations Supplement to the Model Business Corporation Act does authorize an individual holding more than one office in a statutory closed corporation to “execute, acknowledge, or verify in more than one capacity.” *A Report of the Committee on Corporate Laws, Proposed Statutory Close Corporation Supplement to the Model Business Corporation Act*, 37 BUS. LAW. 269, 307 (1981).

¹⁶⁵*See* IND. CODE §§ 23-1-2-5, -4-5, -5-2(f), -5-3(e), -5-8, -7-1.1-42(e) (1982). *See generally* 1981 Survey, *supra* note 70, at 62-63.

¹⁶⁶*See* IND. CODE § 23-1-2-13 (1982).

¹⁶⁷The best proof of corporate authority is the original records of the corporation or a certificate duly authenticated by a responsible officer. The importance of the secretary’s certification and the presence of a corporate seal cannot be overestimated because it creates a presumption that the instrument was duly authorized by the board of directors. *In re Drive-in Development Corp.*, 371 F.2d 215 (7th Cir.), *cert. denied sub nom.*, 387 U.S. 909 (1966).

tion of one person corporations probably favors this development. Two caveats, however, are warranted. The first is that the requirement of section 23-1-2-13, which provides that two or more offices may be held by the same person if the by-laws so provide, has not changed, and, in the absence of such a provision, different individuals must serve as the three statutorily mandated offices. The second is that, whenever corporate procedures are simplified, persons involved with closely held corporations may become careless in complying with the remaining statutory requirements, and that result increases the possibility that the corporate veil will be pierced and personal liability imposed.¹⁶⁸

In 1981, the General Assembly imposed a requirement that the annual reports of all corporations contain "a statement of whether the corporation is the holder of any funds or other property, tangible or intangible, which may be presumed abandoned pursuant to the provisions"¹⁶⁹ of the Indiana Uniform Disposition of Unclaimed Property Act.¹⁷⁰ In 1982, those requirements were repealed by Public Law 144.¹⁷¹ Presumably, Indiana businesses are not unhappy to have a burdensome reporting requirement eliminated, but Indiana taxpayers, in a year when the State avoided a deficit only by holding up income tax refunds, might question the wisdom of vitiating the mechanism for enforcing the Unclaimed Property Act, which is a source of revenue for the state common school fund. The amounts collected under this Act are not insignificant. In 1980, almost two million dollars was collected by the Unclaimed Property Division of the Attorney General's Office.¹⁷²

One statutory development of particular interest to attorneys representing clients whose businesses depend on commercially valuable but nonpublic information is Public Law 145,¹⁷³ which adopted the

¹⁶⁸Public Law 143 also simplified the process of dissolving a corporation before it commences business by amending section 23-1-7-1(a) of the General Corporation Act to eliminate the requirement that such dissolution be done by a majority of incorporators and to permit such dissolution pursuant to a petition signed by any current officer of the corporation and affirmed subject to penalties for perjury. IND. CODE § 23-1-7-1(a) (1982). The procedures for the voluntary dissolution of a corporation that has begun business were not changed in substance, but there were some style changes. *Id.*

¹⁶⁹IND. CODE §§ 23-1-8-1(7), -1-11-7(14), -3-4-1(a) (7), -7-1.1-36(m) (1982).

¹⁷⁰*Id.* at §§ 32-9-1-1 to -45 (1982).

¹⁷¹Act of Feb. 25, 1982, Pub. L. No. 144, 1982 Ind. Acts 1060 (codified at IND. CODE § 23-1-8-1 (1982)). Public Law 144 also amended the Uniform Disposition of Unclaimed Property Act so businesses do not have to file reports with the Unclaimed Property Division of the Attorney General's Office that they do not hold any property presumed abandoned unless requested in writing by the Attorney General or his representative. IND. CODE § 32-9-1-15(f) (1982).

¹⁷²1980 Op. Att'y Gen. xlvi-xlvii.

¹⁷³Act of Feb. 25, 1982, Pub. L. No. 145, 1982 Ind. Acts 1070. The Act is codified at IND. CODE §§ 24-2-3-1 to -8 (1982).

Uniform Trade Secrets Act.¹⁷⁴ The Uniform Trade Secrets Act was approved and recommended for enactment by the National Conference of Commissioners on Uniform State Laws in 1979, after a more than ten-year gestation period.¹⁷⁵

A trade secrets act is a very significant development. A valid patent provides a legal monopoly for seventeen years in exchange for public disclosure of an invention, but if a patent is subsequently declared invalid, there is disclosure of the invention without the protective legal monopoly. Furthermore, many processes or devices will not qualify for patent protection because they are not an "invention," because the process, formula, or device will have a useful life far exceeding the seventeen-year monopoly provided by the patent statute, or because other technical reasons exist.¹⁷⁶

Consequently, many businesses elect to protect commercially valuable information through reliance on state trade secret law. Although the status of trade secret law was uncertain for some time under the federal preemption doctrine,¹⁷⁷ the Supreme Court definitively ruled in *Kewanee Oil Co. v. Bicron Corp.*¹⁷⁸ that neither the patent and the copyright clause of the Constitution¹⁷⁹ nor the federal patent act¹⁸⁰ preempts state trade secret law for protection of patentable or unpatentable devices or information.

The Prefatory Note to the Uniform Trade Secrets Act points out that trade secret law has not developed satisfactorily notwithstanding its commercial importance.¹⁸¹ The Commissioners point out that there is a lack of authority in many jurisdictions and, even in those jurisdictions with significant trade secret litigation, there are uncertainties concerning the extent of trade secret protection and the appropriate remedies for misappropriation of a trade secret.¹⁸² Another important

¹⁷⁴UNIFORM TRADE SECRETS ACT §§ 1-12, 14 U.L.A. 541-51 (1980) [hereinafter cited as UNIFORM ACT].

¹⁷⁵*Id.* at 538-40.

¹⁷⁶*See, e.g.*, 35 U.S.C. § 102(b) (1976) (provides that a person is not entitled to a patent if the invention was in public use or on sale in the United States more than one year prior to the date of the application for the patent).

¹⁷⁷*See* *Sears, Roebuck & Co. v. Stiffel Co.*, 376 U.S. 225 (1964); *Compeco Corp. v. Day-Brite Lighting, Inc.*, 376 U.S. 234 (1964).

¹⁷⁸416 U.S. 470 (1964). *Kewanee* was recently reaffirmed in *Aronson v. Quick Point Pencil Co.*, 440 U.S. 257 (1979), where the Court held that federal patent law did not preclude a contract obligating a party to pay a continuing royalty in exchange for the disclosure of a trade secret for which no patent was issued. *Id.* at 265-66. Even though the contract was upheld in *Aronson*, it has been established that a provision in a patent license agreement providing for royalties beyond the expiration date of the patent is not enforceable. *Brulotte v. Thys Co.*, 379 U.S. 29 (1964).

¹⁷⁹U.S. CONST. art. I, § 8, cl. 8.

¹⁸⁰35 U.S.C. §§ 1-376 (1976).

¹⁸¹UNIFORM ACT, *supra* note 174, at 537.

¹⁸²*Id.*

reason for a specific trade secret statute is that the provisions in the First Restatement of Torts, which was the most frequently cited authority in the development of trade secret law,¹⁸³ were deleted in the second edition of the Restatement published in 1979.¹⁸⁴

A need for uniformity in trade secret law also prompted the Uniform Act. Even those states with a well developed body of trade secret law do not necessarily have uniform laws. This could become a problem as the importance of trade secret protection increases for businesses operating in many different states.

For example, Indiana courts have long prohibited former employees from using trade secrets of employers where there was an understanding that the trade secrets would not be utilized after the employment relationship ended,¹⁸⁵ but the perimeters of the law were ill-defined. Indiana, like most jurisdictions, has criminal sanctions for the improper acquisition of trade secrets.¹⁸⁶ However, criminal sanctions may not provide practical or adequate protection to the owner of a trade secret.

Thus, the adoption of the Uniform Trade Secret Act in Indiana is an important step in protecting legitimate business interests. It is impossible to discuss fully the Indiana Uniform Trade Secrets Act in a survey article, so only the highlights will be noted. The first observation that can be made about the Indiana Uniform Trade Secrets Act is that it, in fact, is not uniform. However, this lack of uniformity is in the form rather than in the substance of the Indiana Act. For some reason, the General Assembly enacted section 9 (short title)¹⁸⁷ and section 8 (uniformity of application and construction)¹⁸⁸ of the Uniform Act as sections 1(a) and 1(b) of the Indiana statute.¹⁸⁹ Further-

¹⁸³See RESTATEMENT OF TORTS §§ 757-59 (1939).

¹⁸⁴The American Law Institute took the position that because trade regulation law in general had developed into an independent body of law which was no longer based primarily upon tort principles, it was no longer appropriate to include those principles in the Restatement. RESTATEMENT (SECOND) OF TORTS introductory note (Vol. 4 1965). See generally Klitzke, *The Uniform Trade Secrets Act*, 64 MARQ. L. REV. 277, 282-84 (1980). See also Note, *Trade Secrets, Customer Contacts and the Employer-Employee Relationship*, 37 IND. L.J. 218, 220-28 (1962).

¹⁸⁵See *Westervelt v. National Paper & Supply Co.*, 154 Ind. 673, 57 N.E. 552 (1900). See also *Koehring Co. v. National Automatic Tool Co.*, 257 F. Supp. 282 (S.D. Ind. 1966), *aff'd*, 385 F.2d 414 (7th Cir. 1967); *Donahue v. Permacel Tape Corp.*, 234 Ind. 398, 127 N.E.2d 235 (1955). See generally Note, *Trade Secrets, Customer Contacts and the Employer-Employee Relationship*, 37 IND. L.J. 218, 220-28 (1962).

¹⁸⁶See IND. CODE §§ 35-42-5-1, -43-4-2, -43-4-3 (1982). 12A R. MILGRAM, BUSINESS ORGANIZATIONS: TRADE SECRETS App. B-1 (1981) contains a list of states with similar criminal sanctions.

¹⁸⁷UNIFORM ACT, *supra* note 174, § 9.

¹⁸⁸*Id.* § 8.

¹⁸⁹IND. CODE § 24-2-3-1(a)-(b) (1982).

more, although section 7 of the Uniform Act displaces “conflicting tort, restitutionary, and other law pertaining to civil liability for misappropriation of a trade secret” except for “(1) contractual or other civil liability or relief that is not based upon misappropriation of a trade secret; or (2) criminal liability for misappropriation of a trade secret,”¹⁹⁰ the comparable Indiana provision displaces all conflicting law pertaining to the misappropriation of trade secrets, except contract law and criminal law.¹⁹¹ Thus, both acts preserve contractually imposed duties relating to secret information, such as covenants not to compete, but only the Uniform Act preserves duties imposed by principles of agency law.¹⁹² Indiana’s failure to preserve agency duties is questionable because it is not inconceivable that a court would rule that the legislature’s decision to omit the language preserving agency principles demonstrates a legislative intent to repeal such law. Hopefully, no court would construe section 1(c) as repealing any principle of agency law and would treat the omission as the elimination of surplusage because section 7 of the Uniform Act displaces only *conflicting* law, and certainly there is no law *requiring* an agent to act in a disloyal fashion.

Another possible problem with the Indiana Act is that the Uniform Act’s severability provision¹⁹³ was omitted. If the omission of the severability clause was a deliberate legislative decision, then it is probable that the General Assembly intended the Indiana Act not to be severable. Consequently, if any provision of the Indiana Act or its application to any person or circumstances were held invalid, the invalidity might also affect the application of other provisions which could be given effect despite the invalid provision.¹⁹⁴ This legislative decision is inexplicable.

Other than these differences, the Indiana Act generally tracks the Uniform Act, although the section numbers differ.¹⁹⁵ The Indiana Act applies to a “trade secret,” which is broadly defined as information with actual or potential independent economic value resulting from its secrecy where there have been reasonable efforts to maintain the

¹⁹⁰UNIFORM ACT, *supra* note 174, § 7.

¹⁹¹IND. CODE § 24-2-3-1(c) (1982).

¹⁹²*See* UNIFORM ACT, *supra* note 174, § 7 commissioners’ comment, at 550.

¹⁹³UNIFORM ACT, *supra* note 174, § 10.

¹⁹⁴The absence of a severability clause creates a presumption that the statute is to be upheld completely or not at all. *Indiana Educ. Employment Relations Bd. v. Benton Community School Corp.*, 266 Ind. 491, 510, 365 N.E.2d 752, 762 (1977). Of course, the General Assembly could have been relying on the general severability clause in the Indiana Code, IND. CODE § 1-1-1-8 (1982), but the omission does raise an issue. *See generally* 2 D. SANDS, STATUTES & STATUTORY CONSTRUCTION §§ 44.03-04.11 (4th ed. 1972).

¹⁹⁵Because sections 7-9 of the Uniform Act were adopted, in part, in section 1 of the Indiana Act, the section numbers of the two acts are off by one. Thus, section 1 of the Uniform Act is section 2 of the Indiana Act.

secrecy.¹⁹⁶ It provides relief for actual or threatened misappropriation of a trade secret. The Indiana Act defines the term "misappropriation" as the "acquisition of a trade secret by a person who knows or has reason to know that the trade secret was acquired by improper means"¹⁹⁷ or the disclosure or use of a trade secret of another without consent.¹⁹⁸ One effect of this broad definition of trade secret is that business information is now clearly treated the same as technical trade secrets; whereas, there was some uncertainty and confusion under the common law.¹⁹⁹

The Indiana Act provides a legal remedy only where there has been a misappropriation, but it makes no difference whether the misappropriation is contractual, tortious, or criminal. This is a decided improvement over the common law, where the misappropriation of a trade secret could be treated only as a contractual or a tortious action.²⁰⁰ The most important remedy under the Indiana Act is injunctive relief.²⁰¹ The statute permits an injunction before there has been any attempt to use or disclose a trade secret. An example would be when a terminated employee is attempting to take trade secret documents. This type of remedy, of course, is very desirable from the standpoint of the employer. The Indiana Act, however, rejects the practice of some courts that grant punitive, perpetual injunctions against someone who has misappropriated a trade secret. Instead, the Indiana Act provides that an injunction should be no longer than a trade secret's life, plus any additional time necessary to negate any "lead time" or commercial advantage obtained through the misappropriation.²⁰² Thus, the injunctive relief lasts as long as, but no longer than, necessary to protect the trade secret.²⁰³

Section 24-2-3-4(a) of the new Indiana Act permits recovery of damages in addition to, or in lieu of, injunctive relief,²⁰⁴ although it appears that no double recovery would be permitted for a misappropriation.²⁰⁵ Recovery for unjust enrichment is also authorized, but only

¹⁹⁶IND. CODE § 24-2-3-2(4) (1982).

¹⁹⁷Improper means is defined to include "theft, bribery, misrepresentation, breach or inducement of a breach of a duty to maintain secrecy, or espionage through electronic or other means." IND. CODE § 24-2-3-2(i) (1982).

¹⁹⁸IND. CODE §§ 24-2-3-2(2)(i)-(ii) (1982).

¹⁹⁹See generally Klitzke, *supra* note 184, at 287-88.

²⁰⁰The distinction between tortious or contractual misappropriation may have been significant at common law because of different statutes of limitation. *Id.* at 296, n.93.

²⁰¹See IND. CODE § 24-2-3-3 (1982).

²⁰²*Id.* § 24-2-3-3(a).

²⁰³See UNIFORM ACT, *supra* note 174, § 2 commissioners' comment, at 544.

²⁰⁴IND. CODE § 24-2-3-4(a) (1982). Double damages may be awarded for a willful and malicious misappropriation. *Id.* § 24-2-3-4(b) (1982).

²⁰⁵See UNIFORM ACT, *supra* note 174, § 3 commissioners' comment; Klitzke, *supra* note

to the extent that unjust enrichment is not taken into account in computing damages for actual loss.²⁰⁶

Section 24-2-3-3²⁰⁷ departs slightly from its counterpart in the Uniform Act. The latter provides that, where the court has determined it would be unreasonable to prohibit future use, an injunction may condition future use upon the payment of a reasonable royalty for the period of time that the use could have been prohibited.²⁰⁸ Under the Indiana Act, an injunction conditioning future use upon payment of a reasonable royalty is limited to "exceptional circumstances," where the court has determined that it would be unreasonable to prohibit future use.²⁰⁹ Both Acts allow a court to award reasonable attorney fees to a prevailing party in specified circumstances.²¹⁰

Of course, an attempt to protect a trade secret would be futile if meritorious litigation would result in the disclosure of the trade secret. Consequently, the Indiana Act authorizes a court, in appropriate circumstances, to order affirmative acts to protect a trade secret.²¹¹ In addition, the Indiana Act authorizes a court to fashion safeguards that preserve the confidentiality of a trade secret during a trial, yet permit a defendant sufficient information to present a defense and permit the trier of fact sufficient information to resolve the dispute on the merits.²¹²

One of the problems with the common law protection of trade secrets was whether the contract or tort statute of limitations applied to a misappropriation of a trade secret.²¹³ Furthermore, there is a split of authority on when the statute begins to run, some courts holding that each day's use of a trade secret constituted a new and discreet "continuing wrong," others holding that the date of the first use of a trade secret started the running of the statute.²¹⁴ The latter line

184, at 304-05. Of course, still to be resolved is whether the Commissioners' Comments will be taken into account in interpreting the Uniform Act, but presumably they will.

²⁰⁶IND. CODE § 24-2-3-4(a) (1982). The practice of some courts is to award damages for actual loss and for unjust enrichment. *See, e.g.,* Telex Corp. v. International Business Mach. Corp., 510 F.2d 894 (10th Cir.), *cert. dismissed*, 423 U.S. 802 (1975). This practice was rejected by the Commissioners. UNIFORM ACT, *supra* note 174, § 3, at 547.

²⁰⁷IND. CODE § 24-2-3-3 (1982).

²⁰⁸UNIFORM ACT, *supra* note 174, § 2(b), at 544.

²⁰⁹IND. CODE § 24-2-3-3(c) (1982). Reasonable royalties can be required for no longer than the period during which the use could have been prohibited when neither damages nor unjust enrichment are provable. *Id.* § 24-2-3-3(b).

²¹⁰*Id.* § 24-2-3-5; UNIFORM ACT, *supra* note 174, § 4. Reasonable attorney fees may be awarded where a specious claim of misappropriation has been made, or where there has been a specious effort to terminate an injunction, or where there has been a willful and malicious misappropriation.

²¹¹IND. CODE § 24-2-3-3(d) (1982).

²¹²*Id.* § 24-2-3-6. *See generally* UNIFORM ACT, *supra* note 174, § 5 commissioners' comment, at 548-49.

²¹³*See generally* Klitzke, *supra* note 184, at 306-07.

²¹⁴*Id.* at 307-08.

of cases obviously shorten the period for which a plaintiff can recover for a misappropriation.

The Indiana Act²¹⁵ takes a compromise position. It specifically provides for a three-year statute of limitations and provides that a continuing misappropriation constitutes a single claim. It further provides that the statute does not begin to run until an aggrieved person discovers, or reasonably should have discovered, the existence of the misappropriation. The statutory solution clarifies the date when the statute begins to run but avoids the inequitable results that could occur if the first-use theory is applied mechanically when there is some time before the owner realizes there has been a misappropriation.²¹⁶

The Uniform Act as adopted in Indiana is a definite advancement in the protection of innovative business ideas. Both patent and trade secret law provide a basis for protecting ideas, but unlike patent law, which is a federal statutory law, trade secret protection was a common law doctrine with many flaws caused by a lack of uniformity and piecemeal development.²¹⁷ Thus, the common law development of trade secret protection has been limited and to some degree ineffective. Now that it is settled that state trade secret law is not preempted by federal patent law, the states should develop an effective doctrine. The Uniform Trade Secret Act provides such a doctrine. Furthermore, the Indiana Act should be of help to Indiana businesses because it is possible that possessors of trade secrets may not have known that the law afforded a remedy for misappropriation. This problem should no longer exist in Indiana.

²¹⁵IND. CODE § 24-2-3-7 (1982). This provision is based on section 6 of the Uniform Act. UNIFORM ACT, *supra* note 174, § 6.

²¹⁶IND. CODE § 24-2-3-8 (1982) provides that the Act does not apply to the part of a continuing misappropriation otherwise covered by the Act which began before September 1, 1982, but it does apply to that part which occurs after August 31, 1982, unless the appropriation was not a misappropriation under displaced Indiana common law. This provision differs from section 11 of the Uniform Act, UNIFORM ACT, *supra* note 174, § 11, which simply states that the Act does not apply to misappropriations occurring prior to the effective date.

Hopefully not too many trade secret misappropriations are occurring in Indiana because apportioning the misappropriation under section 24-2-3-8 and the application of the displaced Indiana common law presents some mindboggling prospects.

²¹⁷See generally Klitzke, *supra* note 184, at 309.