

# Developments in Business Associations Law

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## I. MUNICIPAL ANTITRUST LIABILITY

Just as municipalities and local governments were having prospects of liability under federal antitrust law<sup>1</sup> lessened by congressional<sup>2</sup> and judicial action,<sup>3</sup> the Indiana Court of Appeals has decided a case exposing them to liability under the Indiana Antitrust Act.<sup>4</sup> In *City of Auburn*

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<sup>1</sup>The principal federal antitrust statute is the Sherman Antitrust Act, 15 U.S.C. §§ 1-11 (1982). It is supplemented by the Clayton Antitrust Act. *Id.* §§ 12-26. *See generally* S. OPPENHEIM, G. WESTON & J. MCCARTHY, FEDERAL ANTITRUST LAWS 7-21 (4th ed. 1981); L. SULLIVAN, ANTITRUST § 3 (1977).

<sup>2</sup>The Local Government Antitrust Act of 1984, 15 U.S.C. §§ 34-36 (Supp. 1985), prohibits the recovery of damages, interest, costs, and fees from general or special governmental units which might have violated the antitrust laws. The Act does not immunize the units from antitrust liability because it leaves intact the possibility of injunctive relief. Rather, it removes the incentive of treble damages otherwise available to antitrust plaintiffs. Section 4 of the Clayton Act, *id.* § 15, authorizes the recovery of treble damages, costs, and fees.

<sup>3</sup>In *Town of Hallie v. City of Eau Claire*, 105 S. Ct. 1713 (1985), the United States Supreme Court held that the defendant city was immune from antitrust liability under the state action doctrine of *Parker v. Brown*, 317 U.S. 341 (1943). The effect of *Hallie* was to clarify uncertainty about municipal antitrust liability that followed the Court's decisions in *City of Lafayette v. Louisiana Power & Light Co.*, 435 U.S. 389 (1978), and *Community Communications Co. v. City of Boulder*, 455 U.S. 40 (1982). *Hallie* held that unlike private parties which are entitled to antitrust immunity only if they can demonstrate that the state clearly articulated and affirmatively expressed an anticompetitive policy, *Southern Motor Carriers Rate Conference v. United States*, 105 S. Ct. 1721 (1985), local governments qualify for the *Parker v. Brown* exemption by demonstrating that the state has authorized regulation rather than competition even if it has not compelled such conduct. A general grant of authority to a community such as a typical home rule statute is not sufficient, however, to trigger the exemption. 455 U.S. 40 (1982).

There were more than 250 pending antitrust suits involving local governmental units when *Hallie* was decided. These included *Unity Ventures v. Village of Grayslake and County of Lake*, No. 81C 2745 (N.D. Ill. filed 1981) where a judgment of \$28.5 million was awarded. This judgment would likely bankrupt the municipality. The Local Government Antitrust Act might aid Grayslake because the damage prohibition can be given a retroactive effect under some circumstances. 15 U.S.C. § 35(b) (Supp. 1985).

<sup>4</sup>IND. CODE §§ 24-1-2-1 to -12 (1982). The Indiana Code contains other provisions proscribing anticompetitive conduct. *Id.* §§ 24-1-1-1 to -6; -3-1 to -5; and -4-1 to -4. Although the bulk of antitrust litigation is federal, 16 J. VON KALINOWSKI, BUSINESS ORGANIZATIONS, ANTITRUST LAWS AND TRADE REGULATION § 81.01[5] (rev. ed. 1976), state antitrust laws serve a valid supplementary purpose. *See generally* E. KINTNER, ANTITRUST PRIMER 159-63 (2d ed. 1973). State antitrust laws are not preempted by the federal antitrust laws. *Standard Oil Co. v. Tennessee*, 217 U.S. 413 (1910).

v. *Mavis*,<sup>5</sup> the court affirmed a judgment<sup>6</sup> for plaintiff Mavis following a Whitley Circuit Court jury trial.

Although there are similarities between the Indiana Antitrust Act and the federal antitrust laws,<sup>7</sup> there is no federal counterpart to section 24-1-2-3,<sup>8</sup> which was involved in *Mavis*. Section 24-1-2-3, as it was worded when *Mavis* arose, prohibited schemes or other efforts that "limit, restrain, retard, impede or restrict bidding for the letting of any contract for private or public work . . ." and combinations or conspiracies that "stifle or restrict free competition for the letting of any contract for private or public work. . . ."<sup>9</sup>

Mavis claimed that Auburn and defendant D & L Communications "contrived" to develop radio communication equipment specifications favoring equipment sold by D & L before ostensibly open and competitive bidding to sell radios to the Auburn fire department.<sup>10</sup> Consequently, Mavis did not have a reasonable chance of selling his equipment,<sup>11</sup> and he was injured to the extent of the time lost in preparing a useless bid.<sup>12</sup>

Auburn and D & L did not dispute the judgment that section 24-1-2-3 was violated<sup>13</sup> but argued that Mavis' expenses were inherent in preparing any competitive bid.<sup>14</sup> The court dismissed this argument by noting that collusion between the government and a favored bidder was just the type of conduct section 24-1-2-3 was intended to prohibit. The

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<sup>5</sup>468 N.E.2d 584 (Ind. Ct. App. 1984). Judge Hoffman concurred and filed a separate opinion. *Id.* at 587.

<sup>6</sup>Even though Mavis' damages were trebled under IND. CODE § 24-1-2-7 (1982), his damages of \$1,458 were substantially less than his attorney's fees of \$17,092. 468 N.E.2d at 585. Section 24-1-2-7 is patterned after section 4 of the Clayton Act, 15 U.S.C. § 15 (1982), and authorizes a person injured in business or property by a violation of the Act to bring a civil action seeking treble damages, costs and attorney's fees. The *Mavis* litigation was of long standing. Suit was originally filed in 1974 and resulted in summary judgment for Auburn. This judgment was reversed in 1980. A jury verdict for Mavis was set aside by the trial court. A second verdict for Mavis, which was the subject of the appeal, was entered in March, 1983. 468 N.E.2d at 584 n.1.

<sup>7</sup>See *Sandridge v. Rogers*, 167 F. Supp. 553 (S.D. Ind. 1958); *Dan Purvis Drugs, Inc. v. Aetna Life Ins. Co.*, 412 N.E.2d 129 (Ind. Ct. App. 1980), *discussed in Galanti, Business Associations, 1981 Survey of Recent Developments in Indiana Law*, 15 IND. L. REV. 31, 31-34 (1982); and *Citizens Nat'l Bank v. First Nat'l Bank*, 165 Ind. App. 116, 331 N.E.2d 471 (1975), *discussed in Galanti, Business Associations, 1976 Survey of Recent Developments in Indiana Law*, 10 IND. L. REV. 57, 58-67 (1976).

<sup>8</sup>IND. CODE § 24-1-2-3 (1982).

<sup>9</sup>*Id.* The provision was amended in 1978 to eliminate verbiage. Acts of 1978, Pub. L. No. 2-1978, § 2404, 1978 Ind. Acts 474.

<sup>10</sup>468 N.E.2d at 584.

<sup>11</sup>*Id.* at 586.

<sup>12</sup>The judgment was three times the value of Mavis' lost time. *Id.* at 584-85.

<sup>13</sup>*Id.* at 586.

<sup>14</sup>*Id.*

collusion resulted in the expense of preparing a useless bid, which was what Mavis sought to recover rather than the profits he might have obtained had he secured the bid.<sup>15</sup>

The result in *Mavis* is reasonable on its face, but it is possible to wonder why Auburn did not challenge the finding that it had violated section 24-1-2-3. Certainly the provision can apply to a municipality that tampers with the competitive bidding process, but there is nothing in the language mandating its application.<sup>16</sup> Unlike section 24-1-2-1 of the Indiana Antitrust Act,<sup>17</sup> section 24-1-2-3 contains no absolute requirement of concerted action in either its original or amended form. Thus, it is possible to hold a party such as D & L liable, assuming that its conduct impeded the bidding process, while discharging the municipality.

The word "absolute" is used advisedly because of the recent decision in *Tilbury v. City of Fort Wayne*.<sup>18</sup> *Tilbury* affirmed a summary judgment for the defendants in an action alleging Fort Wayne officials violated section 24-1-2-3 by conspiring to deprive the plaintiff of construction contracts for which he was the lowest bidder.<sup>19</sup> The *Tilbury* rationale was that the defendants were officials, or at least quasi-officials, of Fort Wayne and were acting for the city as an entity. Consequently, the city of Fort Wayne could not "scheme, contract or combine with itself. . . ."<sup>20</sup> *Tilbury*, therefore, interprets the present version of section 24-1-2-3 as requiring concerted action.<sup>21</sup> The provision now uses the terms "scheme, contract or combination."<sup>22</sup> These terms are also used in section 24-1-2-1 of the Act, which does require concerted action.<sup>23</sup>

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<sup>15</sup>*Id.* at 585-86. The court thus distinguished cases cited by Auburn where plaintiffs were denied relief because they had failed to prove they would have received the bid but for the antitrust violation. See *M.C. Mfg. Co. v. Texas Foundries, Inc.*, 517 F.2d 1059 (5th Cir. 1975); *Ovitron Corp. v. General Motors Corp.*, 512 F.2d 442 (2d Cir. 1975); *A.J. Goodman & Son, Inc. v. United States Lacquer Mfg. Corp.*, 81 F. Supp. 890 (D. Mass. 1949); *Urban Prod. Int'l, Ltd. v. National Disposal Serv.*, 32 Ill. App. 3d 299, 336 N.E.2d 138 (1975).

<sup>16</sup>Not surprisingly, there is no legislative history on section 23-1-2-3, which was originally enacted in 1907. Acts of 1907, ch. 243, § 3.

<sup>17</sup>IND. CODE § 24-1-2-1 (1982). This provision is patterned after section 1 of the Sherman Act, 15 U.S.C. § 1 (1982), which requires concerted action.

<sup>18</sup>471 N.E.2d 1183 (Ind. Ct. App. 1984).

<sup>19</sup>*Id.* at 1184.

<sup>20</sup>*Id.* at 1186. The Supreme Court recently took a position similar to *Tilbury* when it overruled the long established intra-enterprise conspiracy doctrine propounded in *United States v. Yellow Cab Co.*, 332 U.S. 218 (1947), and held that a parent corporation could not conspire with its wholly owned subsidiary. *Copperweld Corp. v. Independence Tube Corp.*, 104 S. Ct. 2731 (1984).

<sup>21</sup>471 N.E.2d at 1186.

<sup>22</sup>IND. CODE § 23-1-2-3 (1982).

<sup>23</sup>*Orion's Belt, Inc. v. Kayser-Roth Corp.*, 433 F. Supp. 301 (S.D. Ind. 1977); *Rumple v. Bloomington Hosp.*, 422 N.E.2d 1309 (Ind. Ct. App. 1981).

Of course, statutes are to be construed consistently and harmoniously,<sup>24</sup> but when *Mavis* arose, the wording of the two provisions differed sufficiently to support the proposition that section 24-1-2-3 could apply to unilateral as well as concerted conduct distorting the competitive bidding process. Section 24-1-2-3 did use terms such as "understandings," "arrangements," "contracts," "agreements," or "combinations," which connote concerted action, but the statute also referred to "schemes," "designs," and "plans" which could be formulated and carried out by one entity.<sup>25</sup> The language was changed in 1978 to parallel section 24-1-2-1, which would seem to indicate a legislative intent to change the scope of section 24-1-2-3. It must be recalled, however, that the purpose of the Act that amended the section<sup>26</sup> was to rewrite the criminal sanctions for violating the Act and numerous other Indiana statutes. It is possible the drafters merely intended to eliminate verbiage rather than change the substantive scope of section 24-1-2-3. If so, *Tilbury* might be wrong in narrowly reading section 24-1-2-3. It must be conceded, however, that the present language does tend to connote concerted rather than individual action.

If the *Tilbury* interpretation of section 24-1-2-3 requiring collusion is correct, then the probability of holding a third party such as D & L liable by itself while absolving Auburn is lessened. Otherwise, the result will be something akin to a one person tango. A collusion requirement with respect to public bids would undercut the argument against holding the governmental unit liable for any antitrust violation under section 24-1-2-3.<sup>27</sup>

Assuming there is merit to reducing municipal antitrust exposure, as seems to be the case on the federal level, the General Assembly might well consider revising section 24-1-2-3 to impose liability only on a third party tampering with a competitive bidding process, at least for public works, but not on the governmental unit itself. Recent federal developments<sup>28</sup> bring to question the wisdom of subjecting governmental units to harsh antitrust sanctions. The amounts involved in *Mavis* were small compared to some cases,<sup>29</sup> and there is little likelihood that a judgment of less than \$20,000 will bankrupt Auburn. It must be re-

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<sup>24</sup>471 N.E.2d at 1186 (citing *Matter of Lemond*, 274 Ind. 505, 413 N.E.2d 228 (1980), and *Board of Medical Registration & Examination v. Turner*, 241 Ind. 73, 168 N.E.2d 193 (1960)).

<sup>25</sup>IND. CODE § 24-1-2-3 (1978), amended by Acts of 1978, Pub. L. No. 2, § 2404, 1978 Ind. Acts 474.

<sup>26</sup>Acts of 1978, Pub. L. No. 2, § 2404, 1978 Acts 474.

<sup>27</sup>Section 24-1-2-3 also covers letting of contracts for private works.

<sup>28</sup>See *Town of Hallie v. City of Eau Claire*, 105 S. Ct. 1713 (1985); *Local Government Antitrust Act of 1984*, 15 U.S.C.A. §§ 34-36 (Supp. 1985).

<sup>29</sup>In *Unity Ventures v. Village of Grayslake*, No. 81 C 2745 (N.D. Ill. filed 1981), a judgment of \$28.5 million was entered against the village and Lake County.

membered, however, that the judgment ultimately will be paid by the taxpayers. The purpose of section 24-1-2-3, and of the entire Antitrust Act, is to prohibit anticompetitive behavior,<sup>30</sup> but this objective can be accomplished by making the outside party involved in rigging the bidding process liable.<sup>31</sup> In fact, sole treble damage liability in a case such as *Mavis* might be a more effective deterrent.

The premise of the Supreme Court's decision in *Parker v. Brown*<sup>32</sup> was that Congress did not intend the Sherman Act to displace the field of state economic regulation and that states were free to adopt a system of regulation in lieu of free competition. There are limits to the *Parker v. Brown* exemption,<sup>33</sup> and perhaps the wisdom of permitting states to interfere in economic activities is suspect in this day of deregulation. The rationale, however, is basically a tenet of federalism which might carry over to the relationship between states and local government units. This view does not follow as a matter of course from the recent federal developments, but it is something the General Assembly might wish to consider. The courts may also wish to reconsider the point if section 24-1-2-3 arises again in a suit against an Indiana municipality.<sup>34</sup>

The *Mavis* opinion does not discuss what was done to influence the specifications for the communications equipment. It is possible, however, that efforts to influence specifications to favor one vendor's products should be immune from antitrust challenge as the natural consequence of the need to purchase specialized rather than fungible equipment. Perhaps the D & L system was the best for the needs of the Auburn fire department, and specifications favoring D & L could have benefited

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<sup>30</sup>Royer v. State *ex rel.* Brown, 63 Ind. App. 123, 112 N.E. 122 (1916).

<sup>31</sup>This argument would not apply to rigging the bidding process for private works, which is also proscribed by section 24-1-2-3. In such cases treble damages against both parties would be appropriate in addition to the relief afforded by section 24-1-2-4. IND. CODE § 24-1-2-4 (1982).

<sup>32</sup>317 U.S. 341 (1943).

<sup>33</sup>See, e.g., Cantor v. Detroit Edison Co., 428 U.S. 579 (1976). See generally L. SULLIVAN, ANTITRUST § 238(a)-(b) (1977); Areeda, *Antitrust Immunity for "State Action" after Lafayette*, 95 HARV. L. REV. 435 (1981).

<sup>34</sup>It is unlikely Auburn would be subject to liability if the suit were under the Sherman Antitrust Act because of *Hallie*. In *Community Communications Co. v. City of Boulder*, 455 U.S. 40 (1982), the court held that a broad grant of home rule authority was not sufficient to protect local governmental action from antitrust scrutiny. The Indiana Code, however, specifically authorizes governmental units to establish, maintain, and operate firefighting and fire prevention systems and specifies that they may provide facilities and equipment for a system. IND. CODE § 36-8-2-3 (1982). This should be a sufficient grant of authority to permit an anticompetitive bidding process if the city so desires. The wisdom of such a process is questionable but, presumably, that is a matter for the electorate. Indiana law generally requires bidding for most public works or public purchases of materials and supplies except where relatively small amounts of money are involved. IND. CODE §§ 5-16-1-1.1 to 2-3, 5-17-1-1 to -5, 36-1-12-1 to -5 (1982).

the city. It would be ironic if Auburn were liable for three times Mavis' expenses plus the cost of buying a superior D & L system. Of course, this argument fails where basically fungible products are involved and specifications precluding competitors would be based on irrelevant considerations.<sup>35</sup>

*George R. Whitten, Jr., Inc. v. Paddock Pool Builders, Inc. (Whitten I)*<sup>36</sup> held that an effort by a vendor to influence a public body to adopt its specifications for a public pool was outside the scope of *Parker v. Brown*.<sup>37</sup> *Whitten*, however, gave a particularly narrow reading to the *Noerr-Pennington-Trucking Unlimited* doctrine.<sup>38</sup> Furthermore, it was only a decision on the defendant's motion for summary judgment, and ultimately the defendant prevailed. It was eventually determined that the defendant's unilateral effort to get the municipality to purchase its product was not an antitrust violation.<sup>39</sup> Consequently, D & L's conduct may have been lawful under the Sherman Act, but it must be remembered that there is no federal counterpart to section 24-1-2-3.

In conclusion, *Mavis* cannot be criticized as an implausible reading of section 24-1-2-3 of the Indiana Antitrust Act, particularly as it is now worded. The result of imposing liability on Auburn, however, is open to criticism on policy grounds because the taxpayer of the local governmental unit is the ultimate bearer of the liability. The state should protect the competitive bidding process, but imposing treble damage liability on a vendor who distorts the process, even if the conduct does not violate the Sherman Act,<sup>40</sup> would satisfy this objective.

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<sup>35</sup>A far-fetched example might be specifications for the purchase of paper clips that called for delivery in yellow boxes where one vendor used yellow boxes and all other vendors used green boxes. This is far-fetched, perhaps, but this is the kind of conduct which has no economic justification.

<sup>36</sup>424 F.2d 25 (1st Cir.), *cert. denied*, 400 U.S. 850 (1970).

<sup>37</sup>*Id.* at 31.

<sup>38</sup>See *California Motor Transp. Co. v. Trucking Unlimited*, 404 U.S. 508 (1972); *United Mine Workers of America v. Pennington*, 387 U.S. 657 (1965); *Eastern R.R. Presidents Conference v. Noerr Motor Freight Co.*, 365 U.S. 127 (1961); see also *Metro Cable Co. v. CATV of Rockford, Inc.*, 516 F.2d 220 (7th Cir. 1975) (action by officers of defendant corporation to influence municipality to deny a CATV franchise to plaintiff within doctrine).

<sup>39</sup>*George R. Whitten, Jr., Inc. v. Paddock Pool Builders, Inc.*, 508 F.2d 547 (1st Cir. 1974), *cert. denied*, 421 U.S. 1004 (1975). It has been asserted that the Supreme Court's decision in *Trucking Unlimited*, 404 U.S. 508 (1972), implicitly overruled *Whitten I. Reaemco, Inc. v. Allegheny Airlines*, 496 F. Supp. 546, 556 n.6 (S.D.N.Y. 1980). Some courts, however, have taken the position that the doctrine does not apply where public officials are involved in the conspiracy. *E.g.*, *Duke & Co. v. Foerster*, 521 F.2d 1277, 1281-82 (3d Cir. 1975).

<sup>40</sup>The court of appeals also rejected the city's argument that it should have been permitted to show that other factors led to D & L's getting the contract. 468 N.E.2d at 586. Assuming the position of the court on the liability of Auburn under section 24-1-

## II. SALE OF BUSINESS DOCTRINE

Under Indiana law, as is now the case under federal law, a security is a security is a security. With apologies to Gertrude Stein, this comment reflects the impact of *Wisconics Engineering, Inc. v. Fisher*,<sup>41</sup> which dealt with the so-called "sale of business doctrine" under the Indiana Securities Act.<sup>42</sup> *Wisconics* anticipated the United States Supreme Court decision in *Landreth Timber Co. v. Landreth*,<sup>43</sup> which held that the sale of one hundred percent of the shares of a business was the sale of a "security" within the meaning of federal securities law.<sup>44</sup> The *Landreth* decision resolved a dispute that had generated considerable commentary<sup>45</sup> and sharply divided the circuit courts.<sup>46</sup>

*Wisconics* was an interlocutory appeal of a decision of the Huntington Circuit Court granting summary judgment in favor of plaintiff Fisher against *Wisconics Engineering*<sup>47</sup> and the two principals behind *Wisconics*. *Wisconics Engineering* had purchased one hundred percent of the outstanding shares of Fisher's incorporated business, *Fisher Engineering*.

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2-3 is correct, this holding is correct. If the relationship between D & L and the city in fact was an illegal restraint on the competitive bidding process, the violation occurred before the bidding. Therefore, any factors considered by the city in actually selecting the D & L bid were irrelevant and properly excluded at trial.

<sup>41</sup>466 N.E.2d 745 (Ind. Ct. App. 1984).

<sup>42</sup>IND. CODE §§ 23-2-1-1 to -24 (1982).

<sup>43</sup>105 S. Ct. 2297 (1985). See also *Gould v. Ruefenacht*, 105 S. Ct. 2308 (1985), decided as a companion case to *Landreth*.

<sup>44</sup>The two primary federal securities acts are the Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (1982), and the Securities Exchange Act of 1934, *id.* §§ 78a-78jj (1982).

<sup>45</sup>The *Wisconics* court cited only a few of the articles and comments written on the subject. 466 N.E.2d at 761. See Coffey, *The Economic Realities of a "Security": Is There a More Meaningful Formula?*, 18 CASE W. RES. 367 (1967); Rapp, *Federal Securities Laws Should Protect Some Purchasers of All or Substantially All of a Corporation's Stock*, 32 CASE W. RES. 595 (1982); Selden, *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).

<sup>46</sup>The circuit courts that had adopted the sale of business doctrine included the Seventh, *Canfield v. Rapp & Son, Inc.*, 654 F.2d 459 (1981); *Fredericksen v. Poloway*, 637 F.2d 1147, *cert. denied*, 451 U.S. 1017 (1981); the Ninth, *Landreth Timber Co. v. Landreth*, 731 F.2d 1348 (1984), *rev'd*, 105 S. Ct. 2297 (1985); the Tenth, *Chandler v. K., Inc.*, 691 F.2d 443 (1977); and the Eleventh, *King v. Winkler*, 673 F.2d 342 (1982).

The circuit courts that had rejected the doctrine included the Second, *Golden v. Garafalo*, 678 F.2d 1139 (1982); the Third, *Gould v. Ruefenacht*, 737 F.2d 320 (1984), *aff'd*, 105 S. Ct. 2308 (1985); the Fourth, *Coffen v. Polishing Machines, Inc.*, 596 F.2d 1202, *cert. denied*, 444 U.S. 868 (1979); the Fifth, *Dailey v. Morgan*, 701 F.2d 496 (1983); and the Eighth, *Cole v. PPG Indus., Inc.*, 680 F.2d 549 (1982).

<sup>47</sup>*Wisconics* was a Delaware corporation owned equally by the individual defendants. It had been formed solely for the purpose of acquiring and holding all *Fisher Engineering* shares. 466 N.E.2d at 748.

The individual defendants had guaranteed the promissory note that was the subject of the litigation. The note represented a substantial portion of the purchase price. The court of appeals reversed the judgment for Fisher and remanded.<sup>48</sup>

The business was not as successful as defendants Fitzpatrick and Zenner had anticipated,<sup>49</sup> and eventually Wisconics defaulted on the note.<sup>50</sup> The defendants maintained that Wisconics' problems were the result of Fisher's fraudulent misrepresentations, while Fisher contended the defendants had looted the corporation and misappropriated assets to themselves.<sup>51</sup>

The trial court granted Fisher's second motion for summary judgment.<sup>52</sup> It found, in essence, that the defendants had approached Fisher to buy his business and had been furnished audited corporate financial statements for five years and, more importantly, possessed the business experience to understand the statements.<sup>53</sup> The trial court also concluded that the sale of Fisher Engineering did not involve a sale of a security under the "economic reality test" because the defendants had purchased one hundred percent of the shares and no profits or losses could be derived from the entrepreneurial or managerial efforts of anyone other than themselves.<sup>54</sup>

The defendants raised six issues on appeal,<sup>55</sup> but only two of these are pertinent to this review.<sup>56</sup> The first of these was whether the trial court erred in determining that the defendants had not set forth specific facts supporting their affirmative defense of common law fraud sufficient to preclude summary judgment.<sup>57</sup> The defendants, who had the burden

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<sup>48</sup>*Id.* The court affirmed insofar as the trial court ruled against defendants on their common law fraud defense. *Id.*

<sup>49</sup>*Id.* at 749 n.3.

<sup>50</sup>*Id.* at 750. The note contained an acceleration clause, and all principal and interest became due on default. *Id.* at 749.

<sup>51</sup>*Id.* at 749. The shares had been pledged as security on the note. Fisher elected to vote the shares and regained control of Fisher Engineering. *Id.* at 750. Eventually, the corporation was placed in a bankruptcy reorganization proceeding operated under Fisher's control. *Id.*

<sup>52</sup>*Id.* at 750. The second motion for summary judgment appeared to have been more narrowly focused than the first motion. *Id.*

<sup>53</sup>*Id.* at 750-51.

<sup>54</sup>*Id.* at 751.

<sup>55</sup>*Id.* at 748.

<sup>56</sup>The court rejected four procedural arguments raised by defendants concerning the granting of summary judgment. *Id.* at 751-54. Various arguments were also raised on appeal pertaining to the secured transaction provisions of the Indiana Uniform Commercial Code. IND. CODE §§ 26-1-9-101 to -507 (1982). An impairment of collateral under IND. CODE § 26-1-3-606 was also alleged. The *Wisconics* court concluded that there were issues of fact that had to be resolved with respect to these defenses. 466 N.E.2d at 762-67.

<sup>57</sup>466 N.E.2d at 754-55.

of establishing their affirmative defense,<sup>58</sup> were disadvantaged because their defense consisted of indefinite, imprecise, and general statements about Fisher's representations rather than specific facts which would show a genuine material issue. Regardless of whether the inadequacies of the defendants' affidavits were inadvertent or whether they could not be any more specific under the circumstances, there does not appear to be much doubt that Fisher's alleged representations fell short of actionable common law fraud.<sup>59</sup> In fact, the defendants probably could not have been more specific because they had been given ample opportunity to examine the books, records, and other information on Fisher Engineering.<sup>60</sup>

A particularly interesting aspect of the court's discussion of the fraud issue was its reference to an investment letter signed by the defendants.<sup>61</sup> Some may consider investment letters to be mere technicalities required by the Indiana Securities Act to eliminate the need to register securities before sale. The court, however, gave the investment letter in this case great weight and determined that the letter's representations and statements demonstrated an economic and financial sophistication that would make their claim of reliance on vague general representations by Fisher "inconceivable."<sup>62</sup> *Wisconics* would seem to make it more difficult to allege common law fraud in a securities case where the purchasers have signed an investment letter.

The court of appeals also concluded the defendants' affidavit was inadequate because Fisher's representations were either statements of opinion rather than facts, or were factual representations pertaining to future events.<sup>63</sup> As a general proposition, neither expressions of opinion nor statements as to future expectations are grounds for fraud.<sup>64</sup> This is particularly so where, as here, sophisticated businessmen had the opportunity to scrutinize what they were buying.<sup>65</sup>

The second pertinent issue raised on appeal by the defendants was the trial court's finding that the sale of Fisher Engineering did not involve a sale of a security. By rejecting the "sale of business" doctrine

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<sup>58</sup>*Id.* at 755. The court relied on *Johnson v. Padilla*, 433 N.E.2d 393 (Ind. Ct. App. 1982), and *Costello v. Mutual Hosp. Ins., Inc.*, 441 N.E.2d 506 (Ind. Ct. App. 1982).

<sup>59</sup>*Id.* at 755-59.

<sup>60</sup>*Id.* at 757.

<sup>61</sup>*Id.*

<sup>62</sup>*Id.*

<sup>63</sup>*Id.* at 756, 758-59.

<sup>64</sup>*See* *Automobile Underwriters v. Rich*, 222 Ind. 384, 53 N.E.2d 775 (1944); *Balue v. Taylor*, 136 Ind. 368, 36 N.E. 269 (1893); *Harness v. Horne*, 20 Ind. App. 134, 50 N.E. 395 (1898).

<sup>65</sup>*Wisconics*, 466 N.E.2d at 758. The court pointed out that ordinary prudence and diligence would make Fitzpatrick and Zenner request specific data supporting any representations of profitability. *Id.* at 757-58.

and accepting that the word "security" as used in section 23-2-1-1(k) of the Indiana Securities Act<sup>66</sup> means "stock," whether it is one share of many sold for investment purposes or all shares sold to shift control of a business, the *Wisconics* court subjected Fisher to possible liability under section 23-2-1-12 of the Indiana Securities Act,<sup>67</sup> the antifraud provision of the Act.

Section 23-2-1-12 makes the seller of securities liable for fraudulent acts, for untrue statements of material facts, or for misleading omissions of material facts.<sup>68</sup> The central consideration in determining the materiality of an omission is whether a reasonable investor would attach importance to the information when making an investment decision.<sup>69</sup> Section 23-2-1-12 liability differs from common law fraud in that reliance by the purchaser is not required.<sup>70</sup> There is no assurance that the defendants will prevail in *Wisconics* on remand, but some of Fisher's alleged misrepresentations or omissions might be sufficient to establish a defense to Fisher's suit on the note<sup>71</sup> even though his statements were insufficient to establish a common law fraud defense.

The major portion of the court's discussion on the application of the Indiana Securities Act to the transaction was on the so-called economic reality test utilized by the Seventh Circuit in *Canfield v. Rapp & Son, Inc.*<sup>72</sup> In *Canfield*, the court held that words in the definition section of the Securities Exchange Act of 1934<sup>73</sup> were not to be given their literal meaning and that a share of "stock" was a security for federal securities law purposes only if it: (1) represented an investment in a common venture, and (2) was premised upon a reasonable expectation of profits, (3) to be derived from the entrepreneurial or managerial efforts of others.<sup>74</sup> Under this rationale, the sale of a going concern that just

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<sup>66</sup>IND. CODE § 23-2-1-1(k) (1982). As the *Wisconics* court noted, relying on *Arnold v. Dirrim*, 398 N.E.2d 426 (Ind. Ct. App. 1979), securities fraud is broader in scope than common law fraud. 466 N.E.2d at 759 n.8.

<sup>67</sup>IND. CODE § 23-2-1-12 (1982).

<sup>68</sup>The provision is patterned after section 101 of the Uniform Securities Act, UNIF. SEC. ACT § 101, 7A U.L.A. 568 (Master ed. 1978), which in turn is patterned after SEC rule 10b-5, 17 C.F.R. § 240.10b-5 (1982).

<sup>69</sup>*Arnold*, 398 N.E.2d at 433. See generally Galanti, *Business Associations, 1980 Survey of Recent Developments in Indiana Law*, 14 IND. L. REV. 91 (1981).

<sup>70</sup>*Arnold*, 398 N.E.2d at 435-36.

<sup>71</sup>466 N.E.2d at 759-60.

<sup>72</sup>654 F.2d 459 (7th Cir. 1981), discussed in Galanti, *Business Associations, 1982 Survey of Recent Developments in Indiana Law*, 16 IND. L. REV. 25, 41-46 (1983) [hereinafter cited as *1982 Survey*].

<sup>73</sup>15 U.S.C. § 78c(a)(10) (1982). *Canfield* also alleged a violation of the Securities Act of 1933, *id.* § 77q(a). The definition of security in the 1933 Act is substantially the same as the definition in the 1934 Act and they are considered functional equivalents. *Canfield*, 654 F.2d at 463 n.5.

<sup>74</sup>654 F.2d at 463. The *Canfield* court, as well as the other courts that had adopted

happens to be structured as a stock transfer is not subject to federal antifraud rules because the essence of the transaction is the transfer of the business to which the "stock sale" was a mere incident.

As noted above, the circuits were split on the sale of business doctrine, and some courts specifically rejected a narrow reading of security.<sup>75</sup> In *Golden v. Garafalo*<sup>76</sup> and *Gould v. Ruefenacht*,<sup>77</sup> the courts reasoned that the economic reality test was appropriate where an "unusual or unique" instrument was involved but not when the instrument was labeled "stock" and possessed all the characteristics typically associated with stock.<sup>78</sup> It was this reading of the definition of security that prevailed in the Supreme Court.<sup>79</sup>

The Seventh Circuit is now bound to follow *Wisconics* in applying Indiana law in diversity or pendent jurisdiction cases under the *Erie* doctrine<sup>80</sup> and *Landreth* and *Gould* in applying federal law. This is worth noting because, in *Canfield*, the Seventh Circuit also applied its narrow definition of security under federal securities law to the Indiana Securities Act.<sup>81</sup>

The *Wisconics* court, in rejecting the sale of business doctrine,<sup>82</sup> found support for its position in *B & T Distributors, Inc. v. Riehle*.<sup>83</sup> The court of appeals in *Riehle*<sup>84</sup> had concluded section 23-2-1-12 applied to the sale of a business<sup>85</sup> and this aspect of the case was affirmed by the Indiana Supreme Court.<sup>86</sup> Although *Riehle* is not the clearest decision and was subsequently reversed, it did apply the antifraud provision to the sale of a business. This was an implicit recognition that the transaction was a sale of securities within the meaning of section 23-2-1-1(k). However, the sale of business doctrine was not directly considered in the case.

No one can seriously argue that the narrow view of decisions like *Canfield* is implausible. Nor can it be seriously denied that it may be

the sale of business doctrine, relied on *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975), although the instrument involved in *Forman* labeled "stock" really represented only an interest in a cooperative apartment.

<sup>75</sup>See *supra* note 46.

<sup>76</sup>678 F.2d 1139 (2d Cir. 1982).

<sup>77</sup>737 F.2d 320 (3d Cir. 1984), *aff'd*, 105 S. Ct. 2308 (1985).

<sup>78</sup>*Golden*, 678 F.2d at 1143.

<sup>79</sup>*Landreth*, 105 S. Ct. at 2302. See generally Galanti, 1982 Survey, *supra* note 72, at 43-44.

<sup>80</sup>*Erie R.R. v. Tompkins*, 304 U.S. 64 (1938).

<sup>81</sup>*Canfield*, 654 F.2d at 463 n.5.

<sup>82</sup>466 N.E.2d at 761.

<sup>83</sup>266 Ind. 646, 366 N.E.2d 178 (1977).

<sup>84</sup>359 N.E.2d 622 (Ind. Ct. App. 1977), *rev'd on other grounds*, 266 Ind. 646, 366 N.E.2d 178 (1977).

<sup>85</sup>359 N.E.2d at 624-25.

<sup>86</sup>266 Ind. 646, 647, 366 N.E.2d 178, 179 (1977).

inappropriate to subject a sale of an entire business to attack under federal or state securities laws simply because it is structured as a stock transfer where a similar but differently structured transaction can be attacked only on common law fraud grounds. As the *Wisconics* court rightly noted,<sup>87</sup> however, this really is a matter for legislative determination.<sup>88</sup>

### III. SECURITIES FRAUD

Another interesting case involving the Indiana Securities Act decided during the survey period was *Crook v. Shearson Loeb Rhoades, Inc.*<sup>89</sup> Crook sued Shearson,<sup>90</sup> alleging that actions of two Shearson brokers violated the antifraud provisions of the federal Commodity Exchange Act<sup>91</sup> and the Indiana Securities Act<sup>92</sup> and constituted common law fraud.<sup>93</sup> Shearson counterclaimed for a debit balance in Crook's account.<sup>94</sup>

Crook apparently did not appreciate the risk involved in trading commodity futures. He made a profit on some trades, but overall he suffered substantial investment losses.<sup>95</sup> Eventually, Shearson liquidated his account, but there was a large debit balance even after taking funds from a money market account.<sup>96</sup>

It also appears that the two brokers might have overreached because there was no evidence that Crook had given them discretionary authority to trade his account.<sup>97</sup> Furthermore, they neither followed Shearson procedures relating to new commodity trading accounts nor determined if speculative investments were appropriate for Crook.<sup>98</sup>

The court concluded that Crook did not understand the concept of "margin" and its significance in commodity trading.<sup>99</sup> He apparently

<sup>87</sup>466 N.E.2d at 762.

<sup>88</sup>Defendants were not satisfied with a substantial reduction in attorney's fees awarded to Fisher. *Id.* at 767-68. The court of appeals concluded they were challenging the decision to award fees rather than the reasonableness of the fees. Defendants were successful to the extent that the award could be predicated only upon a favorable judgment on the promissory note and the decision on the note was reversed. *Id.* at 768. This is clearly right, but it is certainly reasonable to anticipate that fees would be imposed on defendants if Fisher should happen to prevail at the trial.

<sup>89</sup>591 F. Supp. 40 (N.D. Ind. 1983).

<sup>90</sup>Now known as Shearson/American Express, Inc. *Id.* at 42.

<sup>91</sup>7 U.S.C. § 6(b) (1976).

<sup>92</sup>IND. CODE §§ 23-2-1-12, -19 (1982).

<sup>93</sup>591 F. Supp. at 42.

<sup>94</sup>*Id.*

<sup>95</sup>*Id.* at 47.

<sup>96</sup>*Id.* Crook apparently hoped that the market would rally to cover his losses and a bad check he had given Shearson. *Id.*

<sup>97</sup>*Id.* at 43.

<sup>98</sup>*Id.* at 44.

<sup>99</sup>*Id.* at 43.

had signed a Shearson Commodity Customer Agreement but had not received a Risk Disclosure Statement that should have been attached to the agreement.<sup>100</sup> More significantly, the court concluded that even if he had received this statement, the true risks involved would not have been fully explained.<sup>101</sup>

Obviously, Crook was not an appropriate investor to be engaged in commodity trading. He understood that substantial profits could be made in a short time by such investing, but he did not understand that the *quid pro quo* for these possible riches was the possibility of substantial losses. Nor did he understand the steps or procedures that could limit losses in such trading.<sup>102</sup>

The *Crook* decision should give persons in the securities industry some concern because now the broker operates at his peril if he merely gives documents explaining investment risks. It will take a clear record of explanation as to what is involved to preclude the unsuccessful investor from claiming he or she has not been apprised of the risks. This might not be a significant problem with the typical person investing in stocks, but it could be with an unsophisticated, speculative investor in options or futures.<sup>103</sup>

The complaint in *Crook* alleged a violation of section 6b(A)<sup>104</sup> of the Commodity Exchange Act. This provision is similar to section 10(b) of the Securities Exchange Act of 1934,<sup>105</sup> and there is an implied right of action under section 6b<sup>106</sup> just as there is under section 10(b). It is well settled that negligent conduct is not enough to establish liability under section 10(b) and Rule 10b-5, and a plaintiff must show scienter to prevail.<sup>107</sup> However, the negligence-scienter issue has not been settled under the Commodity Exchange Act.<sup>108</sup> The *Crook* court concluded it

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<sup>100</sup>*Id.* at 43-44.

<sup>101</sup>*Id.* at 44.

<sup>102</sup>*Id.* at 48.

<sup>103</sup>At a minimum, *Crook* warns brokerage firms to examine commodity customer agreements to determine if there has been a change in the customer's status. The court noted that a new account agreement was executed by the plaintiff in January, 1980, and that a commodity customer agreement received in July, 1980, indicated "a change in occupation and title." It concluded that "an occupational change could signal a change in the financial condition of a customer about which a broker should inquire." 591 F. Supp. at 44.

<sup>104</sup>7 U.S.C. § 6b(A) (1982).

<sup>105</sup>15 U.S.C. § 78j(b) (1982).

<sup>106</sup>*Merrill Lynch, Pierce, Fenner & Smith v. Curran*, 456 U.S. 353 (1982).

<sup>107</sup>*Aaron v. SEC*, 446 U.S. 680 (1980); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976).

<sup>108</sup>The Commodity Futures Trading Commission has concluded negligence can support liability under section 6b(A). *Gordon v. Shearson Hayden Stone, Inc.*, COMM. FUT. L. REP. (CCH) ¶ 21,016 (1980). This position has been rejected by some courts. *First Commodity Corp. v. CFTC*, 676 F.2d 1, 4 (1st Cir. 1982). Another court views the scienter question

did not have to decide the issue because the brokers had acted recklessly,<sup>109</sup> and recklessness has satisfied the scienter requirement in cases brought under both the Securities Exchange Act<sup>110</sup> and the Commodity Exchange Act.<sup>111</sup>

The most intriguing aspect of *Crook* for purposes of this review is the discussion of the Indiana Securities Act. The court quoted section 23-2-1-12,<sup>112</sup> which prohibits fraudulent practices in connection with the offer, sale, or purchase of a security. The court then stated that "I.C. 23-2-1-19 provides for the recovery of damages if a violation is proven."<sup>113</sup> Section 23-2-1-12 is similar to section 101 of the Uniform Securities Act,<sup>114</sup> and although the language of these provisions is similar to the language of section 10(b), it has been held that the standard of liability is negligence rather than scienter.<sup>115</sup> Because the evidence established the scienter necessary, or perhaps necessary, for a violation of section 6b(A) of the Commodity Exchange Act, the negligence standard of section 23-2-1-12 was clearly satisfied.<sup>116</sup>

There is only one problem with the court's discussion of the Indiana Securities Act. Section 23-2-1-19<sup>117</sup> is patterned after section 410(a) of the Uniform Securities Act,<sup>118</sup> which provides for damages if a violation is established and the investor no longer owns the security.<sup>119</sup> Unfortunately, section 23-2-1-19(a) was amended in 1975 to eliminate the language referring to damages if the securities are no longer owned by the investor, which appears to leave rescission as the only authorized remedy for an injured purchaser.<sup>120</sup> Unlike section

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as unsettled. *Kotz v. Bache Halsey Stuart, Inc.*, 685 F.2d 1204, 1207 (9th Cir. 1982).

<sup>109</sup>591 F. Supp. at 48. Scienter would seem necessary for a violation of section 6b(A) because the provision makes unlawful actions that "cheat or defraud or attempt to cheat or defraud." This is much stronger language than found in section 10(b) of the 1934 Act and implementing rule 10b-5. 17 C.F.R. § 240.10b-5 (1982).

<sup>110</sup>*E.g.*, *Sanders v. John Nuveen & Co.*, 554 F.2d 790 (7th Cir. 1977); *Sundstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033 (7th Cir.), *cert. denied*, 434 U.S. 875 (1977).

<sup>111</sup>*See Kotz*, 685 F.2d at 1207; *First Commodity Corp.*, 676 F.2d at 4.

<sup>112</sup>IND. CODE § 23-2-1-12 (1982).

<sup>113</sup>591 F. Supp. at 49.

<sup>114</sup>UNIF. SEC. ACT. § 101, 7A U.L.A. 568 (Master ed. 1978).

<sup>115</sup>*Rousseff v. Dean Witter & Co., Inc.*, 453 F. Supp. 774 (N.D. Ind. 1978). *See also* *State v. Fries*, 214 Neb. 874, 337 N.W.2d 398 (1983); *Bradley v. Hullander*, 272 S.C. 6, 249 S.E.2d 86 (1978); *State v. Temby*, 108 Wis. App. 521, 322 N.W.2d 528 (1982).

<sup>116</sup>591 F. Supp. at 49.

<sup>117</sup>IND. CODE § 23-1-2-19 (1982).

<sup>118</sup>UNIF. SEC. ACT § 410, 7A U.L.A. 670 (Master ed. 1978).

<sup>119</sup>Section 23-2-1-19 provided for damages when *Rousseff*, relied on by the *Crook* court, arose. *Rousseff*, 453 F. Supp. at 778.

<sup>120</sup>Act of April 30, 1975, Pub. L. No. 265-1975, § 15, 1975 Acts 1402, 1444 (amending IND. CODE § 23-2-1-19 (1972)). The primary purpose for amending § 23-2-1-19 was to

410,<sup>121</sup> nothing in section 23-2-1-19 authorizes a damage action for transactions after 1975. Certainly it cannot be argued that the Indiana General Assembly *impliedly* created a cause of action where securities are no longer owned by repealing statutory language *expressly* creating a cause of action. The current language of section 23-2-1-19 appears to have escaped the notice of the parties and the court, or perhaps it was simply ignored. Because Crook had been closed out of his position in 1980, he no longer owned any security.<sup>122</sup>

The court also discussed Crook's allegation that Shearson's liability could be based on common law fraud.<sup>123</sup> It concluded there was a fiduciary relationship between Crook and the Shearson brokers who exercised *de facto* control over his account and that the elements of common law fraud under Indiana law were satisfied.<sup>124</sup> The court found that the brokers failed to disclose all material facts and did not adequately explain the material facts that were disclosed.<sup>125</sup>

Although awarding damages under section 23-2-1-19 might be questionable, the Commodity Exchange Act violation and common law fraud justified compensatory damages.<sup>126</sup> Crook did not get all he wanted because the court rejected his claim for punitive damages.<sup>127</sup> Shearson may have acted recklessly, but it did not do so knowingly or deliberately.<sup>128</sup> Punitive damages to deter future misconduct were considered inappropriate because Shearson had procedures and policies designed to protect unsophisticated investors such as Crook and it only had to follow them.<sup>129</sup> Of course, if there are procedures that have been ignored, punitive damages might be appropriate to ensure that brokerage firms will keep a tighter rein on brokers. However, if the court is right in insisting that the terms of agreements such as the Shearson Commodity Customer Agreements have to be explained to and completely understood by customers under penalty of punitive damages, the potential liability

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give a cause of action to sellers as well as purchasers of securities. *See generally* Galanti, *Business Associations, 1975 Survey of Recent Developments in Indiana Law*, 9 IND. L. REV. 33, 63 (1975).

<sup>121</sup>Damages are available for violations of § 12(2) of the Securities Act of 1933, 15 U.S.C. § 77(l)(2) (1982), from which § 410 was derived.

<sup>122</sup>591 F.Supp. at 47.

<sup>123</sup>*Id.* at 49-50.

<sup>124</sup>*Id.* *See* Hall-Hottel Co. v. Oxford Square Co-op, Inc., 446 N.E.2d 25 (Ind. Ct. App. 1983); Peoples Trust Bank v. Braun, 443 N.E.2d 875 (Ind. Ct. App. 1983); Plymale v. Upright, 419 N.E.2d 756 (Ind. Ct. App. 1981); Fleetwood Corp. v. Mirich, 404 N.E.2d 38 (Ind. Ct. App. 1980).

<sup>125</sup>591 F. Supp. at 50.

<sup>126</sup>*Id.* at 50-52. The court did not fix the precise amount of recovery because it was not aware of the appropriate interest rate. *Id.* at 51-52.

<sup>127</sup>*Id.* at 50-51.

<sup>128</sup>*Id.* at 51.

<sup>129</sup>*Id.*

of brokerage firms would be draconian. Compensatory damages plus interest probably is appropriate relief for investors like Crook.<sup>130</sup>

#### IV. CLOSELY HELD CORPORATIONS, FIDUCIARY DUTIES, AND DERIVATIVE SUITS

One case decided during the survey period demonstrates the problems that can flow from a casually run family business. It also decided several issues pertaining to shareholder derivative actions which had not been resolved previously by Indiana courts. Consequently, the decision in *Dotlich v. Dotlich*<sup>131</sup> is worth noting by Indiana attorneys representing closely held corporations. In *Dotlich*, the court of appeals affirmed in substantial part a judgment of the Johnson Circuit Court against two directors of a closely held corporation.<sup>132</sup>

The action by Sam Dotlich, one of four brothers, against two of his brothers alleged fraud and breach of their fiduciary duties as directors of a family corporation in which the four brothers were directors and equal shareholders. The dispute was over ownership of various parcels of real estate. The trial court imposed a constructive trust on property held by defendant Monnie Dotlich, ordering him to convey it to the corporation. Monnie was also assessed compensatory and, with his brother Mechel, punitive damages as well as attorney's fees and costs. The trial court also appointed a receiver to take over the business of the corporation. Sam, Mechel, and the fourth brother, Merko Dotlich, were ordered to reimburse the corporation for the value of their homes which had been built with corporate funds. The court of appeals affirmed the judgment except for the attorney fee award and the assessing of punitive damages against Mechel Dotlich.<sup>133</sup>

The corporation was a successor to a partnership of the four brothers. Real estate purchased by the partnership with partnership funds had been titled in Monnie's name.<sup>134</sup> Even after the two family corporations

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<sup>130</sup>The court awarded Crook reasonable attorney's fees, except for expenses and attorney's fees for a deposition which had to be cancelled because of inclement weather. *Id.* at 52. Crook's conduct barred full recovery from Shearson even though Shearson had failed to follow its own policies to prevent investors such as Crook from engaging in commodities trading. Once Crook began "using" Shearson, hoping the market would rally, he became the guilty party, justifying an award to Shearson on its counterclaim. *Id.*

<sup>131</sup>475 N.E.2d 331 (Ind. Ct. App. 1985).

<sup>132</sup>*Id.* at 350-51.

<sup>133</sup>Defendant Monnie Dotlich counterclaimed for an accounting. The counterclaim was severed from the derivative action and was pending at the time of the *Dotlich* decision. *Id.* at 337-38.

<sup>134</sup>It is interesting to speculate whether the problems that beset the Dotlich brothers could have been avoided if the title to the real estate had been taken in the name of the partnership as clearly permitted by § 23-4-1-8(3) of the Indiana Uniform Partnership Act.

were formed,<sup>135</sup> title to property purchased with corporate funds, except for the residences,<sup>136</sup> was put in Monnie's name alone.<sup>137</sup> Monnie claimed ownership in the six parcels of real estate titled in his name. Mechel sided with Monnie on this issue and claimed absolute ownership of his home. Sam and Merko contended the corporation beneficially owned all nine parcels.<sup>138</sup> Sam did not discover the property title situation until 1976.<sup>139</sup> He attempted to have the corporation remedy the title irregularities for all nine parcels, but he was not successful.<sup>140</sup> It was clear at this point that Monnie was claiming all property in his name.<sup>141</sup> Sam's suit charged Monnie and Mechel with breaching their fiduciary duty to the corporation by converting corporate opportunities to their own benefit. Monnie was accused of mismanaging corporate affairs, and Mechel was accused of aiding and abetting.<sup>142</sup>

Several issues were raised on appeal,<sup>143</sup> most of which related to business associations law.<sup>144</sup> The first issue was whether Sam could be an adequate representative for the corporation in maintaining a derivative action as required by Indiana Trial Rule 23.1.<sup>145</sup> The defendants argued that Sam was disqualified because his home was constructed with corporate funds on property purchased with corporate funds and so engaged

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IND. CODE § 23-4-1-8(3) (1982). See generally J. CRANE & A. BROMBERG, LAW OF PARTNERSHIP § 38 (1968).

<sup>135</sup>Only one of the corporations was involved in the litigation. 475 N.E.2d at 336.

<sup>136</sup>*Id.* The homes of three of the brothers, including the plaintiff's, were purchased and maintained by the corporation although titled in the names of the individuals.

<sup>137</sup>*Id.*

<sup>138</sup>*Id.* at 337.

<sup>139</sup>*Id.*

<sup>140</sup>Before Sam filed the shareholder derivative action he introduced a resolution at a meeting of the directors to have all corporate property titled in the corporate name. This motion failed to pass when the two defendant directors voted against it. *Id.*

<sup>141</sup>*Id.*

<sup>142</sup>The fourth brother, Merko, was brought in as a necessary party to the action. *Id.* The suit sought to have the property conveyed to the corporation and to assess punitive damages against the defendants. It also requested a court-appointed receiver for the corporation.

The trial court entered a judgment in favor of the corporation, imposing a constructive trust on Monnie and compelling him to transfer title to the corporation. The three homes were found to be corporate property and the three brothers were ordered to pay the corporation the value of their respective residences. This issue was deemed to have been tried by the implied consent of the parties. *Id.* at 349-50. Punitive damages, attorney's fees, and expenses were assessed against Monnie and Mechel in favor of the corporation. *Id.* at 337-38.

<sup>143</sup>475 N.E.2d at 338.

<sup>144</sup>The defendants also raised statute of frauds and statute of limitation issues. 475 N.E.2d at 340-42.

<sup>145</sup>IND. R. TR. P. 23.1. The rule bars a derivative action if it appears that the plaintiff does not fairly and adequately represent the interest of shareholders in enforcing the right of the corporation.

in the same misconduct charged against them.<sup>146</sup> The *Dotlich* court recognized that where all shareholders participate in a wrongful act, no shareholder would be able to bring a derivative suit,<sup>147</sup> and even the corporation would be barred from suing.<sup>148</sup> It rejected this argument under the circumstances because Sam recognized the corporation beneficially owned his residence, while the defendants were resisting the corporation's claim.<sup>149</sup>

Mechel further argued that Sam was both plaintiff and defendant in suing derivatively. This argument was properly rejected even though there is no Indiana authority directly on point.<sup>150</sup> The flaw in Mechel's argument was that it ignored the fundamental premise that a derivative action is an indirect effort to enforce the rights of the corporation and not an effort to pursue rights personal to the shareholder.<sup>151</sup>

He also argued that a director should not be able to bring a derivative action.<sup>152</sup> The court, relying on the New York case of *Tenney v. Rosenthal*,<sup>153</sup> held that a shareholder who is a director is not barred from suing derivatively because the right to sue facilitates performance of a director's stewardship obligation.<sup>154</sup> *Tenney* involved a statute authorizing a director to sue derivatively, but *Dotlich* used this policy ground to justify applying the rationale to all derivative suits.<sup>155</sup> This result is clearly correct. To rule otherwise would mean that a minority director wishing to protect the interests of a corporation would be precluded from doing so. He would be unable to get the board of directors to act, and would be unable to sue as a shareholder because he was on the board. This

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<sup>146</sup>475 N.E.2d at 339.

<sup>147</sup>*Id.*

<sup>148</sup>See *Ross v. Tavel*, 418 N.E.2d 297 (Ind. Ct. App. 1981). See generally 13 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 5972 (Callaghan 1984). It is even possible for the sins of a shareholder to live beyond his ownership. For example, in *Bangor Punta Operations, Inc. v. Bangor & Aroostook R.R.*, 417 U.S. 703 (1974), and *Home Fire Ins. Co. v. Barber*, 67 Neb. 644, 93 N.W. 1024 (1903), the corporations were unable to bring an action in their own names where the present owners were unable to bring derivative suits because they were not contemporaneous owners. This presents the ironic situation of not being able to do something directly because the same action could not be done indirectly.

<sup>149</sup>475 N.E.2d at 339. There is nothing unusual in the resolution of this issue and, in fact, it is consistent with *Gabhart v. Gabhart*, 267 Ind. 370, 370 N.E.2d 345 (1977).

<sup>150</sup>The *Dotlich* court relied on 13 W. FLETCHER, *supra* note 148, at § 5947.

<sup>151</sup>In unusual cases, it is possible that relief in a derivative action may run in favor of minority shareholders rather than the corporation. *E.g.*, *Perlman v. Feldman*, 219 F.2d 173 (2d Cir. 1955), *cert. denied*, 349 U.S. 952 (1954).

<sup>152</sup>475 N.E.2d at 339.

<sup>153</sup>6 N.Y.2d 204, 189 N.Y.S.2d 158, 160 N.E.2d 463 (1959).

<sup>154</sup>475 N.E.2d at 339.

<sup>155</sup>The same rationale has been used to permit minority trustees to sue majority trustees on behalf of a charitable corporation. *Holt v. College of Osteopathic Physicians*, 61 Cal. 2d 250, 40 Cal. Rptr. 244, 394 P.2d 932 (1964).

“Catch-22” situation could eliminate the derivative action in the context of closely held corporations.

Both defendants also argued that Sam had not alleged the particular efforts to obtain the requested relief as required by Rule 23.1. They contended that the demand required by the rule must be explicit.<sup>156</sup> The court recognized that under certain circumstances the demand requirement is excused.<sup>157</sup> The demand was not excused in *Dotlich*, but Sam’s resolution attempting to have all parcels titled in the corporate name was sufficient because the board of directors had had the opportunity to remedy the complaint and avoid litigation.<sup>158</sup> The failure to pass the resolution was a rejection of “nonjudicial efforts to obtain the relief requested in the derivative complaint.”<sup>159</sup>

One aspect of the defendants’ statute of limitations argument should be noted. They argued that Sam’s lack of knowledge of Monnie’s claim did not constitute the active concealment needed to toll the running of the statute.<sup>160</sup> The court recognized, relying on *Forth v. Forth*,<sup>161</sup> that concealing a cause of action entails some kind of “trick” or contrivance. It concluded, however, that Monnie’s fiduciary duty to the corporation and the other shareholder-directors obviated the need for active and intentional concealment.<sup>162</sup> His failure to disclose his intentions concerning the property tolled the statute and all actions were timely.<sup>163</sup> This is one more indication of the willingness of Indiana courts to hold principals in closely held corporations to a rather high standard of loyalty.<sup>164</sup>

*Dotlich* also refined the concept of corporate opportunity under Indiana law. The court emphasized that Monnie had the burden of proving he had not violated his fiduciary duty. The law presumes fraud when it is shown that a fiduciary has attempted to benefit from a questioned transaction.<sup>165</sup> At this point the burden of proof shifts to

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<sup>156</sup>475 N.E.2d at 340.

<sup>157</sup>*Id.* at 340 n.2. *Tevis v. Hammersmith*, 31 Ind. App. 281, 66 N.E. 912, *aff’d*, 161 Ind. 74, 67 N.E. 672 (1903).

<sup>158</sup>475 N.E.2d at 340.

<sup>159</sup>*Id.*

<sup>160</sup>*Id.* at 341.

<sup>161</sup>409 N.E.2d 641 (Ind. Ct. App. 1980).

<sup>162</sup>475 N.E.2d at 341. The court relied on *Forth*, 409 N.E.2d 641 (Ind. Ct. App. 1980), and *Guy v. Schuldt*, 236 Ind. 101, 138 N.E.2d 891 (1956).

<sup>163</sup>475 N.E.2d at 341.

<sup>164</sup>*Id.* See *Cressy v. Shannon Continental Corp.*, 177 Ind. App. 224, 378 N.E.2d 941 (1978), discussed in Galanti, *Business Associations, 1979 Survey of Recent Developments in Indiana Law*, 13 IND. L. REV. 133, 150-55 (1980); *Hartung v. Architects Hartung/Odle/Burke, Inc.*, 157 Ind. App. 546, 301 N.E.2d 240 (1973), discussed in Galanti, *Business Associations, 1974 Survey of Recent Developments in Indiana Law*, 8 IND. L. REV. 24, 42-46 (1974). See also *Motor Dispatch, Inc. v. Buggie*, 177 Ind. App. 347, 353-54, 379 N.E.2d 543, 547 (1978).

<sup>165</sup>See *Lucas v. Frazee*, 471 N.E.2d 1163 (Ind. Ct. App. 1984).

the fiduciary to overcome the presumption and show the actions were honest and done in good faith.<sup>166</sup> This approach is similar to the "two step" approach of the Minnesota courts in *Miller v. Miller*<sup>167</sup> and *A.C. Petters Co. v. St. Cloud Enterprises, Inc.*<sup>168</sup> These decisions adopt the flexible view that a corporate opportunity exists not only when the corporation has an actual interest in the property but also when the opportunity is closely associated with the existing or prospective activities of the corporation.<sup>169</sup> Once the threshold question of the opportunity is established by the corporation or a shareholder, the burden is shifted to the insider to show the questioned conduct was fair and equitable to the corporation. If this cannot be done, the corporation will prevail. This approach to the corporate opportunity doctrine protects the interests of the corporation and has the added benefit of protecting the interests of insiders who might be able to justify conduct which facially appears to usurp a corporate opportunity.<sup>170</sup> The *Dotlich* court did not expressly adopt this position, but it does fit the *Dotlich* result and is a logical continuation of cases like *Hartung*<sup>171</sup> and *Cressy*.<sup>172</sup>

Another interesting issue in *Dotlich* was the liability of Mechel Dotlich, who sided with his brother, defendant Monnie.<sup>173</sup> The court made it clear that normally a director is not liable for the misconduct of a co-director,<sup>174</sup> but a director who has participated in the wrongdoing,<sup>175</sup> or who learns of it and takes no action, or who acquiesces, is liable.<sup>176</sup> Mechel was found to have breached his duty when he learned of but did not disclose Monnie's claim, thus aiding and abetting Monnie's

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<sup>166</sup>*Id.* See also *Blaising v. Mills*, 176 Ind. App. 141, 374 N.E.2d 1166 (1978); *Schemmel v. Hill*, 91 Ind. App. 373, 169 N.E. 678 (1930); *Zaring v. Kelly*, 74 Ind. App. 581, 128 N.E. 657 (1920). Of course, defendants had the additional problem of appealing from a negative judgment and could prevail only if the evidence was uncontradicted and led unerringly to a conclusion different from that of the trial court. *Captain & Co. v. Town*, 404 N.E.2d 1159 (Ind. Ct. App. 1980).

<sup>167</sup>222 N.W.2d 71 (Minn. 1974).

<sup>168</sup>222 N.W.2d 83 (Minn. 1974).

<sup>169</sup>222 N.W.2d at 79-80.

<sup>170</sup>Compare *Petters*, 222 N.W.2d 83 (Minn. 1974), with *Irving Trust Co. v. Deutsch*, 73 F.2d 121 (2d Cir. 1934), *cert. denied*, 294 U.S. 708 (1935). See generally W. CARY & M. EISENBERG, *CORPORATIONS* 594-600 (5th ed. 1980); H. HENN & J. ALEXANDER, *LAWS OF CORPORATIONS* § 237 (3rd ed. 1983).

<sup>171</sup>*Hartung v. Architects Hartung/Odle/Burke, Inc.*, 157 Ind. App. 546, 301 N.E.2d 240 (1973).

<sup>172</sup>*Cressy v. Shannon Continental Corp.*, 177 Ind. App. 244, 378 N.E.2d 941 (1978).

<sup>173</sup>475 N.E.2d at 343. Of course, Mechel did wish to keep title to his residence.

<sup>174</sup>*Id.*

<sup>175</sup>See *Rosenbloom v. Electric Motor Repair Co.*, 31 Md. App. 711, 358 A.2d 617 (1976); *McDonough v. Jones*, 48 Or. App. 785, 617 P.2d 948 (1980).

<sup>176</sup>See *In re Illinois Acceptance Corp.*, 531 F. Supp. 737 (C.D. Ill. 1982); *Reid v. Robinson*, 64 Cal. App. 46, 220 P. 676 (1923).

breach.<sup>177</sup> This issue appears to be a close call, but what apparently tipped the case against Mechel was his failure to vote for the resolution to have all property titled in the corporate name.<sup>178</sup>

Another corporate law issue decided in *Dotlich* was the appropriateness of appointing a receiver for the corporation. The court recognized that section 23-1-7-3(b)<sup>179</sup> of the General Corporation Act would not support the appointment because that section applies to involuntary dissolutions.<sup>180</sup> However, the court was satisfied that Indiana Code sections 34-1-12-1(3) and (7) support the appointment of a receiver in extraordinary cases where, as here, there appears to be overreaching by a controlling person.<sup>181</sup>

Both defendants appealed from the award of punitive damages.<sup>182</sup> The award was affirmed as to Monnie but reversed as to Mechel.<sup>183</sup> The court concluded that even under the clear and convincing standard of *Traveler's Indemnity Co. v. Armstrong*,<sup>184</sup> Monnie's acts exceeded negligence and amounted to "willful, malicious and oppressive" conduct which is sufficient to support punitive damages.<sup>185</sup> It is interesting to note that punitive damages were assessed despite the fact that no compensatory damages were awarded.<sup>186</sup> Normally an award of compensatory damages is a prerequisite to punitive damages,<sup>187</sup> but *Dotlich* clearly puts Indiana among those jurisdictions which hold that equitable relief can support an award of punitive damages.<sup>188</sup> The constructive trust imposed on Monnie satisfied this element. Mechel, however, had not been sub-

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<sup>177</sup>475 N.E.2d at 343.

<sup>178</sup>*Id.* at 343-44.

<sup>179</sup>IND. CODE § 23-1-7-3(b) (1982).

<sup>180</sup>*See* Crippen Printing Corp. v. Abel, 441 N.E.2d 1002 (Ind. Ct. App. 1982), *discussed in* Galanti, *Business Associations, 1983 Survey of Recent Developments in Indiana Law*, 17 IND. L. REV. 31, 33-38 (1984). There was no showing of imminent irreparable injury that would have justified an involuntary dissolution.

<sup>181</sup>IND. CODE §§ 34-1-12-1(3), (7) (1982). *See* Tri-City Elec. Service Co. v. Jarvis, 206 Ind. 5, 185 N.E. 136 (1933).

The *Dotlich* court was satisfied that appointing the receiver was not an abuse of discretion because defendant Monnie was the managing director treating corporate property as his own. 475 N.E.2d at 344-45.

<sup>182</sup>475 N.E.2d at 345.

<sup>183</sup>*Id.* at 345-47.

<sup>184</sup>442 N.E.2d 349 (1982).

<sup>185</sup>475 N.E.2d at 346.

<sup>186</sup>*Id.*

<sup>187</sup>*See, e.g.,* Hahn v. Ford Motor Co., 434 N.E.2d 943 (Ind. Ct. App. 1982).

<sup>188</sup>*Hedworth v. Chapman*, 135 Ind. App. 129, 192 N.E.2d 649 (1963). *See also, Starkovich v. Noye*, 111 Ariz. 347, 529 P.2d 698 (1974); *Charles v. Epperson & Co.*, 258 Iowa 409, 137 N.W.2d 605 (1965); *I.H.P. Corp. v. 210 Central Park S. Corp.*, 16 App. Div.2d 461, 228 N.Y.S.2d 883 (1962), *aff'd*, 12 N.Y.2d 329, 239 N.Y.S.2d 547, 189 N.E.2d 812 (1963); *Kneeland v. Bruce*, 47 Tenn. App. 136, 336 S.W.2d 319 (1960); *National Bank of Commerce v. May*, 583 S.W.2d 685 (Tex. Civ. App. 1979).

jected to either equitable relief or compensatory damages. Consequently, there was no justification for imposing punitive damages on him, and the award was reversed.<sup>189</sup>

The defendants were successful in the area that perhaps affected them the most "out of pocket." The trial court had ordered them to reimburse the corporation approximately \$350,000 for attorney's fees, and ordered the corporation to pay the fees to the plaintiff's attorneys.<sup>190</sup> Because Indiana follows the American rule prohibiting an award of attorney fees against a losing party,<sup>191</sup> the award could stand only if the case fell within one of three exceptions. "Obdurate behavior" was the one possible exception applicable, but because of a recent Indiana Supreme Court decision<sup>192</sup> establishing that the exception is aimed at plaintiffs who bring baseless litigation, the *Dotlich* court concluded it did not apply. Here the corporation prosecuted the action, and, in any event, any obdurate behavior occurred before the suit.<sup>193</sup>

In conclusion, *Dotlich* is a case that resolves and clarifies some issues of corporate law pertaining to closely held corporations, fiduciary duties, and derivative suits. *Dotlich v. Dotlich* is an all too common example of a closely held corporation run in a very informal manner. Informality normally does not create great problems, but as this case makes clear, people who operate corporations casually may end up losing in an intracorporate dispute.

## V. PARTNERSHIP INTEREST VALUATION

*Hamilton Airport Advertising, Inc. v. Hamilton*,<sup>194</sup> decided during the survey period, is a case that might have been avoided if the partnership agreement had been better drafted. In *Hamilton*, the court affirmed in part and reversed in part a judgment of the Hancock Superior Court against defendants in a suit brought by the surviving spouse of a deceased partner, William Hamilton, against the partnership, the two surviving partners, and two affiliated corporations.<sup>195</sup>

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<sup>189</sup>475 N.E.2d at 347.

<sup>190</sup>*Id.*

<sup>191</sup>*Trotcky v. Van Sickle*, 227 Ind. 441, 85 N.E.2d 638 (1949).

<sup>192</sup>*Kikkert v. Krumm*, 474 N.E.2d 503 (Ind. 1985).

<sup>193</sup>The court did uphold reassessment of costs against the defendants, 475 N.E.2d at 348, and the award of attorney's fees in favor of the plaintiff's law firm against the corporation. *Id.* at 348-49. Charging the corporation with the shareholders' legal fees is customary in derivative suits because, after all, the suit should have been prosecuted by the corporation itself. See H. HENN & J. ALEXANDER, *supra* note 170.

<sup>194</sup>462 N.E.2d 228 (Ind. Ct. App. 1984).

<sup>195</sup>*Id.* at 230. The two surviving partners were brothers of the deceased. The three brothers were equal partners, and the sole shareholders, officers, and directors of the two corporations. *Id.*

After William's death, the plaintiff and one of the individual defendants executed a document estimating that the value of William's corporate shares under buy-sell agreements and the approximate value of his "interest" in the partnership was \$125,000.<sup>196</sup> Some payments were made to the plaintiff under this document. When payments were stopped, the plaintiff sued for breach of the valuation agreement, fraud, and an accounting.<sup>197</sup> The defendants moved to dismiss and filed a counterclaim.<sup>198</sup> The major dispute in *Hamilton* was over the meaning and interpretation of the buy-sell provision in the partnership agreement,<sup>199</sup> which specified that the price for the "interest" of a deceased partner was \$25,000 plus an amount equal to what would have been distributable to him out of net profits for the ensuing twelve months.<sup>200</sup>

The partnership was structured so that partnership funds were deposited in accounts called either drawing accounts or capital accounts.<sup>201</sup> The partners could not withdraw all funds in their accounts because the funds were needed as working capital.<sup>202</sup> The plaintiff characterized the difference between William's account at his death and the smaller of the two remaining accounts as a loan to the partnership. She claimed this amount in addition to the purchase price established by the buy-sell agreement.<sup>203</sup> Defendants objected to treating the account as a loan because there was no promissory note as required by the partnership agreement.<sup>204</sup> They argued that the estate had been overpaid because the amounts in the three accounts should have been averaged and this figure deducted from William's account.<sup>205</sup> The trial court apparently accepted the plaintiff's figures in rendering judgment in her favor.<sup>206</sup>

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<sup>196</sup>*Id.* at 231.

<sup>197</sup>*Id.*

<sup>198</sup>*Id.* The defendants' motion to dismiss the accounting action was granted by the trial court. *Id.*

<sup>199</sup>*Id.*

<sup>200</sup>*Id.* at 232.

<sup>201</sup>*Id.*

<sup>202</sup>*Id.* William had drawn the least amount from his share of partnership earnings. *Id.*

<sup>203</sup>*Id.* at 233.

<sup>204</sup>*Id.* The defendants objected to the plaintiff's expert witness interpreting the partnership agreement. The court of appeals noted that the construction of written contracts is a question of law to be decided by the courts in the absence of ambiguity, *Interstate Auction, Inc. v. Central Nat'l Ins. Group, Inc.*, 448 N.E.2d 1094 (Ind. Ct. App. 1983); *English Coal Co. v. Durholz*, 422 N.E.2d 302 (Ind. Ct. App. 1981), and that in such cases expert testimony on the matter of interpretation is improper. *Federal Life Ins. Co. v. Sayre*, 195 Ind. 7, 142 N.E. 223 (1924). The court characterized this evidence as not influencing the result in the case and ignored it as harmless error. 462 N.E.2d at 235.

<sup>205</sup>462 N.E.2d at 233. This reasoning does present the anomalous result of penalizing William for not drawing down his account.

<sup>206</sup>*Id.* at 234. The judgment was for approximately \$65,000. This included amounts

The trial court also appeared to have accepted the purported settlement agreement as valid and binding but then inconsistently admitted evidence as to the actual value of William's interest in the three ventures.<sup>207</sup> The court of appeals concluded that the actual valuation issue had been tried by consent and that the reference to the settlement agreement was but a "minor technical" discrepancy.<sup>208</sup> Consequently, it ignored the agreement<sup>209</sup> and attempted to construe the terms of the partnership agreement "to determine exactly what the three partners contracted for and what they actually did."<sup>210</sup> In effect, the court did what the Hamiltons should have done by making it absolutely clear what their estates were to receive when they died.

The problem with the agreement was that it was unclear in its definition of "drawing accounts." The relevant paragraph referred to distribution of earnings as well as to specific withdrawals necessary for the payment of income taxes.<sup>211</sup> The court concluded that partnership earnings had been distributed equally to each partner and that this was proper.<sup>212</sup> Consequently, William's estate was entitled to the funds remaining in his account.<sup>213</sup>

The *Hamilton* court then had to consider the proper price for William's interest under the partnership buy-sell provision. There was no dispute that the price for his "share and interest in the partnership" was to be \$25,000 plus one-third of the net profits of the business for the next year,<sup>214</sup> but the parties disagreed whether the price was for all claims and interests in the partnership, including William's partnership account. The court concluded it was not.<sup>215</sup> Again, the problem stemmed from the agreement's reference to "drawing accounts," although proper drafting of partnership agreements calls for two separate accounts for each partner: a capital or investment account and a current or drawing

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owed under the corporate buy-sell agreements which were not in dispute and prejudgment interest. *Id.* at 234-35.

<sup>207</sup>*Id.* at 235.

<sup>208</sup>*Id.*

<sup>209</sup>*Id.*

<sup>210</sup>*Id.* at 236. The court itself pointed out one example of faulty drafting of the documents. *Id.* at n.6.

<sup>211</sup>The court concluded distribution did not mean disbursement and it was not a substitute for withdrawal, but rather meant that funds were to be divided equally among the three, whether withdrawn or not. 462 N.E.2d at 237. This is analogous to federal income taxation of partnerships where a partner's share of current partnership net earnings is deemed to be distributed at the close of the tax year regardless of whether the funds were actually distributed. *Stackhouse v. United States*, 441 F.2d 465 (5th Cir. 1971).

<sup>212</sup>462 N.E.2d at 236.

<sup>213</sup>*Id.*

<sup>214</sup>*Id.* at 237.

<sup>215</sup>*Id.*

account.<sup>216</sup> The court concluded that funds left in each partner's account were capital,<sup>217</sup> rather than loans, particularly since there were no promissory notes. The court followed the view expressed in the early New Jersey case of *Molineaux v. Reynolds*<sup>218</sup> that funds not drawn out at the end of the year but left in the business with the acquiescence of all partners are to be treated as capital contributions unless accumulated earnings are specifically excluded from capital accounts.<sup>219</sup>

There is an irony here. The court accepted the position urged by the defendants by refusing to treat William's account as a loan, but rejected their related contentions that the agreement's reference to the "entire share and interest in the partnership" meant just what it said. Instead, the court found that "interest" did not include repayment of William's capital contribution.<sup>220</sup> The court reasoned that under the Indiana General Partnership Act a partner's "interest" in the partnership is his or her share in the profits and surplus of the venture<sup>221</sup> excluding capital contributions.<sup>222</sup>

Distinguishing between profits and surplus on one hand and capital on the other is correct, but the *Hamilton* court's next step of excluding the capital account from the buy-sell agreement might be questioned. It could be an unwise move financially, but partners can agree as to their rights *inter se*,<sup>223</sup> even allowing surviving partners to take all partnership property and the estate of a deceased partner to take nothing.<sup>224</sup> Perhaps the Hamiltons really intended the agreed purchase price to cover everything. Under the Uniform Partnership Act, a sale of a partner's interest entitles the purchaser only to the assigning partner's profits.<sup>225</sup> The Act is silent as to capital owed the selling partner, but if the

<sup>216</sup>See generally M. VOLZ & A. BERGER, *THE DRAFTING OF PARTNERSHIP AGREEMENTS* 116-17 (6th ed. 1976).

<sup>217</sup>462 N.E.2d at 238. The court noted there are cases where cash contributions to capital are labeled "capital accounts," citing *J.M. Schultz Seed Co. v. Robertson*, 451 N.E.2d 62 (Ind. Ct. App. 1983), although in *Robertson* the court found no partnership existed. See generally Galanti, *Business Associations, 1984 Survey of Recent Developments in Indiana Law*, 18 IND. L. REV. 57, 73-76 (1985).

<sup>218</sup>35 A. 536 (N.J. Ch. 1896).

<sup>219</sup>462 N.E.2d at 238-39. Accumulated earnings will not be treated as capital if excluded by agreement. *Dore v. LaPierre*, 226 N.Y.S.2d 949 (N.Y. Sup. Ct. 1962).

<sup>220</sup>462 N.E.2d at 239.

<sup>221</sup>IND. CODE § 23-4-1-26 (1982).

<sup>222</sup>*Id.* §§ 23-4-1-40(b)(3), (4). Capital is treated differently because it is a liability of the partnership owed to a partner, while a partner's interest is, in effect, a partnership asset.

<sup>223</sup>See *Trifunovic v. Marich*, 168 Ind. App. 464, 343 N.E.2d 825 (1976).

<sup>224</sup>See generally J. CRANE & A. BROMBERG, *supra* note 134, at 508 n.46.

<sup>225</sup>IND. CODE § 23-4-1-27(1) (1982).

partnership is subsequently dissolved, the purchaser or assignee is entitled to the assignor's interest in partnership property.<sup>226</sup>

The court, however, probably is right in requiring a clearer indication that the term "interest" should be construed broadly before excluding repayment of capital.<sup>227</sup> After all, it is not likely the Hamiltons would have left their funds in the business if they had known they were going to receive only \$25,000 plus one year's earnings. Of course, it would have been better if the agreement had spelled out the treatment of the capital account as well as any other accounts,<sup>228</sup> and the litigation might have been avoided if they had done so.

It is also possible to wonder why the court of appeals did not follow the trial court's lead and enforce the purported settlement agreement valuing William's interest in all three ventures at \$125,000. Payments to plaintiff plus the judgment approximated this figure. Perhaps receiving evidence as to the actual value of the enterprise should have been treated as the "minor technical discrepancy." After all, the surviving spouse and the surviving partner who signed the settlement agreement must have meant something by the \$125,000 amount. It could have been their estimation of the entire value of William's interest in the two corporations and the partnership.

If this is the case, there is a two-fold message in *Hamilton*. Valuation provisions in buy-sell agreements should be drafted carefully. If they are not, the parties might be well-advised to abide by any conclusions about the value of a decedent's interest rather than litigating the question.

## VI. STATUTORY DEVELOPMENT

1. *Corporation Law Study Commission*.—The most significant statutory development during the survey period might be better described as a potential development. The General Assembly established a General Corporation Law Study Commission<sup>229</sup> to consider revising the present Indiana General Corporation Act. The present Act was adopted in 1929.<sup>230</sup> It has been subject to several major revisions,<sup>231</sup> and some amendments to the Act are passed in almost every session of the General Assembly. However, there has not been a complete examination of Indiana's statutory corporate law in over fifty years. It is rather obvious that the

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<sup>226</sup>*Cf.* *Parker v. Donald*, 477 S.W.2d 947 (Tex. Civ. App.), *rev'd*, 482 S.W.2d 846 (1972).

<sup>227</sup>This raises the interesting question of what would have happened if the partnership had no assets after repaying the capital accounts. Presumably, under the court's reasoning, it would still be obligated to purchase the interest for \$25,000.

<sup>228</sup>*See generally* M. VOLZ & A. BERGER, *supra* note 216, at 16.

<sup>229</sup>Act of April 16, 1985, Pub. L. No. 362-1985, § 1.

<sup>230</sup>Acts of 1929, ch. 215, § 1.

<sup>231</sup>Acts of 1949, ch. 194, § 1; Acts of 1967, ch. 275, § 1.

corporate world of 1929 is quite different from the corporate world of 1986. A statute that was advanced for the time has become obsolete to a significant extent, and provisions which caused no problems to the corporate bar then are now obstacles to efficient structuring and management of corporations.

The present Act gives the organizers of a corporation some flexibility in structuring the corporation to fit their desired goals and objectives. This is particularly true for small closely held corporations which have been aptly described as "incorporated partnerships."<sup>232</sup> Unfortunately, there are some provisions in the Act that can cause problems if the drafter of the articles is not careful.<sup>233</sup> At the other end of the size spectrum, the relatively recent phenomenon of massive corporate takeovers with a myriad of defensive moves by management is raising problems not contemplated by the drafters of most current corporation acts. Some proposed statutory responses to tender offers might be undesirable,<sup>234</sup> but some statutory changes aimed at the more egregious features of the current tender offer scene, such as "greenmail,"<sup>235</sup> might be worthwhile.

The Study Commission primarily is considering the Revised Model Business Corporation Act (1984) adopted by the Committee on Corporate Laws of the Section of Corporation, Banking and Business Law of the American Bar Association.<sup>236</sup> The Revised MBCA strikes, on the whole, a good balance between the interests of corporate management, which desires "flexibility," and the interests of passive shareholders who some-

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<sup>232</sup>Hartung v. Architects Hartung/Odle/Burke, Inc., 157 Ind. App. 546, 552, 301 N.E.2d 240, 243 (1973).

<sup>233</sup>For example, certain provisions in the Act are optional with the drafter if specified in the articles while others can be specified in either the articles or the bylaws. *Compare* IND. CODE § 23-1-2-11(g) with § 23-1-2-11(i).

Many states have adopted statutes specifically drafted for closely held corporations. *See, e.g.*, MD. CODE ANN. CORPS. & ASS'NS §§ 4-101 to -603 (1985). There is also a Model Statutory Close Corporation Supplement Appended to the Revised Model Business Corporation Act. 3 MODEL BUSINESS CORP. ACT ANN. § 1803-79 (3d ed. 1985). Presumably, the Study Commission will consider adopting a special close corporation statute. There are arguments that broad general statutes coupled with judicial liberality give drafters of articles of incorporation sufficient flexibility, *see* *Galler v. Galler*, 32 Ill. 2d 16, 203 N.E.2d 577 (1964), and that specific statutes might impose arbitrary restrictions. The benefits of a statute, however, would seem to outweigh any detriments. *See generally* W. CARY & M. EISENBERG, *supra* note 170, at 400-09.

<sup>234</sup>For example, the New York legislature passed a bill intended to thwart Ted Turner's takeover of C.B.S. The editors of *The Wall Street Journal*, *Wall St. J.*, July 10, 1985, at 24, col. 1, not surprisingly opposed the bill and urged Governor Mario Cuomo to veto it.

<sup>235</sup>Greenmail is the practice of a corporate suitor acquiring a substantial block of shares of a target company with the intent of having management purchase the shares at a hefty profit rather than with the intent of actually pursuing a tender offer.

<sup>236</sup>REVISED MODEL BUSINESS CORP. ACT §§ 1.01 to 17.06 (1984).

times lose out in what Justice Brandeis characterized as the "race of the lax."<sup>237</sup>

There is only one problem this author sees with adopting the Revised MBCA. The General Assembly might not be able to apply a new corporation act to Indiana corporations organized since July 1, 1978, unless the provisions of the new Act are expressly adopted by those corporations. July 1, 1978, was the effective date of the repeal of section 23-1-12-5 of the Indiana General Corporation Act.<sup>238</sup> This provision was the "reservation of powers" clause that reserved to the legislature the right to amend or repeal the law relating to corporations.

The reserved powers clause was not in the present Act when it was adopted in 1929. It was added in 1949.<sup>239</sup> Frederick Schortemeier, who chaired the Indiana Corporations Survey Commission at the time, commented that it was felt the state had "inherent power" to amend the Corporation Act but that it was advisable to make the power express.<sup>240</sup> The repeal of section 23-1-12-5 at least raises the possibility that a court will rule that the General Assembly decided in 1978 that Indiana should not have authority to affect subsequently organized corporations by amending or repealing the Act.

The drafters of the Revised MBCA operated on the premise that the Act should apply to all existing as well as new corporations.<sup>241</sup> They also intended it to be a substitute for existing general incorporation statutes<sup>242</sup> and recommended against retaining portions of earlier statutes.<sup>243</sup> Of course, they also operated on the premise that there has been a "universal adoption of 'reservation of power' clauses in all states for more than a century . . .,"<sup>244</sup> which is not the case in Indiana.

<sup>237</sup>Liggett Co. v. Lee, 288 U.S. 517, 559 (1933) (Brandeis, J., dissenting).

<sup>238</sup>Act of July 1, 1978, Pub. L. No. 2-1978, § 3602, 1978 Ind. Acts 472 (repealing IND. CODE § 23-1-12-5 (1972)).

<sup>239</sup>Acts of 1949, ch. 194, § 22.

<sup>240</sup>F. SCHORTEMEIER, INDIANA CORPORATION LAW 206 n.11 (1952).

<sup>241</sup>REVISED MODEL BUSINESS CORP. ACT § 17.01 (1984).

<sup>242</sup>3 MODEL BUS. CORP. ACT ANN. § 17.05, official comment at 1800 (3d ed. 1985).

<sup>243</sup>*Id.*

<sup>244</sup>*Id.* § 17.01, official comment at 1797. Section 1.02 of the Revised Model Business Corporation Act is the reservation of powers clause.

There is dictum in *City of Indianapolis v. Navin*, 151 Ind. 139, 143, 47 N.E. 525, 526-27 (1897), that the legislature had inherent power to regulate fares of a common carrier. This might be the source of Mr. Schortemeier's comment, *supra* note 240. However, the court's statement was merely dictum because the legislature had reserved the power. Furthermore, the court recognized that the power over fares would be surrendered by "clear and unmistakable language" inconsistent with the exercise of such power. *Id.* There is no clearer or more unmistakable statement of legislative intent to surrender the reserved power than expressly repealing the clause.

The decision in *State ex rel. Stanley v. Alaska Airlines, Inc.*, 68 Wash. 2d 318, 413 P.2d 352 (1966), contrasts with the *Navin* dictum. In *Alaska Airlines*, the court held that

As of this writing, the author does not know how the Study Commission will handle the problem caused by the repeal of section 23-1-12-5, assuming it agrees that there is a problem. Perhaps it will not, and a new Indiana General Corporation Act will be made applicable to existing Indiana corporations. Maybe there does not have to be an express reserved powers clause as contemplated by section 17.01 of the Revised MBCA, but certainly any lawyer worthy of the title "professional" would argue that a new Corporation Act could not apply to corporations organized after July 1, 1978, when it was in his or her client's interest that it not be applied. Of course, the same can be said about all amendments to the Indiana General Corporation Act adopted since 1978.

2. *Securities Act Registration.*—Although it will affect relatively few corporations, an amendment to section 2 of the Indiana Securities Act<sup>245</sup> recognizes the maturing of the over-the-counter securities market. The amendment added a new subsection exempting securities designated for trading in the National Association of Securities Dealers Automatic Quotation (NASDAQ) National Market System (NMS), from the Act's registration requirements.<sup>246</sup>

This amendment puts companies in the NMS on par with companies with securities listed or approved for listing on the major stock exchanges.<sup>247</sup> Such companies are exempt from the registration requirements of state securities acts<sup>248</sup> because of the belief that the listing standards of the exchanges coupled with the disclosure requirements imposed on the public sale of securities by the Securities Act of 1933<sup>249</sup> adequately protects the interest of investors. Subjecting these companies to additional registration requirements merely increases the cost of an offering with no gain to the investing public.

The NMS includes the soundest and most seasoned companies traded over-the-counter.<sup>250</sup> NASDAQ criteria and public information on NMS companies is similar to that available on listed companies, so a similar

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provisions in the Model Business Corporation Act which had been adopted in Alaska could not be made applicable to a corporation organized under the previous territorial corporation act which had not contained a reservation of powers clause.

<sup>245</sup>Act of April 18, 1985, Pub. L. No. 232-1985, § 2 (codified at IND. CODE § 23-2-1-2(a)(11) (Supp. 1985)). The act also exempts securities designated for trading on any other national market system approved and designated by the Indiana Securities Commissioner, any other security of the same issuer that is of senior rank or of substantially equal rank, any security called for by subscription rights or warranty so listed or approved, or any warrant or right to purchase or subscribe to any of these securities. *Id.*

<sup>246</sup>IND. CODE § 23-2-1-2 (1982).

<sup>247</sup>*Id.* § 23-2-1-2(a)(5).

<sup>248</sup>*See, e.g.,* UNIF. SEC. ACT § 402(a)(8), 7B U.L.A. 600 (master ed. 1968).

<sup>249</sup>15 U.S.C. § 77(e) (1982).

<sup>250</sup>Approximately 1700 of the 4700 companies quoted on NASDAQ are in the NMS.

registration exemption is appropriate.<sup>251</sup> Indiana is the first state to recognize the stature of the NMS by a registration exemption, but it would be very surprising if this exemption does not become commonplace.

The merit of the new amendment is not the number of companies it will affect, but the recognition of the waste in requiring seasoned, sound companies to register securities under both the federal and state securities acts. Eliminating the state requirement will reduce the red tape involved in public securities offerings of NMS companies, thus expediting the raising of capital. Of course, companies that do not meet the NMS requirements, even if they are quoted in NASDAQ, must still satisfy the registration or qualification requirements of the Indiana Securities Act, which protects the interest of Indiana investors. Also, it is important to note that the exemption of section 23-2-1-2(a) is from the registration requirements of the Act and not the antifraud provisions<sup>252</sup> which apply to the sales of such securities.<sup>253</sup>

3. *Share Exchanges*.—The past session of the General Assembly authorized the acquisition of a corporation's shares by a share exchange, cash, other consideration, or a combination of the three.<sup>254</sup> It also set out the procedures for an exchange.<sup>255</sup> The net effect of sections 23-1-5-1(3) and 23-1-5-9 is to provide a procedure for the direct exchange of shares in a corporate acquisition while maintaining the same safeguards and rights available to shareholders of corporations participating in mergers or consolidations.

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Katterjohn, *Indiana Exempts Certain NASDAQ Stocks*, *Indpls. Bus. J.*, April 22-28, 1985, at 3A, col. 1.

<sup>251</sup>*Id.* at 16A, col. 4. The NMS exemption will not affect many Indiana corporations. There are 17 Indianapolis over-the-counter stocks included in the NMS System, and three others are eligible for inclusion but have not yet been added. *Id.*

<sup>252</sup>IND. CODE § 23-2-1-12 (1982).

<sup>253</sup>The new amendment also repealed the registration exemption for memberships issued by nonprofit organizations, IND. CODE § 23-2-1-2(a)(6) (1984) (repealed 1985); authorized the Securities Commissioner to impose civil penalties on violators of the Indiana Securities Act, *id.* § 23-2-1-19.5 (Supp. 1985); exempted from registration the offer or sale of securities pursuant to a statutory exchange, *id.* § 23-2-1-2(b)(15) (amended 1985); and made minor stylistic changes.

<sup>254</sup>Act of April 14, 1985, Pub. L. No. 231-1985, § 1 (amending IND. CODE § 23-1-5-1(3) (Supp. 1985)).

The Act made minor revisions to other provisions of the General Corporation Act to integrate the new procedure into the existing act. This includes amending IND. CODE § 23-1-11-15 (Supp. 1985), to authorize the exchange of securities with a foreign corporation if such an exchange is permitted by the laws of the state under which the foreign corporation is organized.

Since 1977, the Indiana Insurance Law has contained provisions authorizing an exchange of securities of insurance companies. IND. CODE §§ 27-3-1-1 to -7 (1982).

<sup>255</sup>Act of April 14, 1985, Pub. L. No. 231-1985, § 2 (adding IND. CODE § 23-1-5-9 (Supp. 1985)).

The new provisions recognize that parties to a corporate combination might wish to keep the acquired corporation as a separate and distinct entity, as opposed to merging or consolidating. This result could be obtained before section 23-1-5-1(3) was adopted, but it was a complicated procedure. The acquiring corporation had to form a new subsidiary into which the acquired corporation merged, with the shares of the acquired corporation being converted into the shares of the parent corporation. Section 72A of the Model Business Corporation Act is similar but not identical to section 23-1-5-1(3). The drafters of the MBCA commented when section 72A was added in 1976: "This procedure is often cumbersome and requires the utilization of a number of extraneous technical steps that have no real substance."<sup>256</sup>

As mentioned, section 23-1-5-1(3) and the procedures of section 23-1-5-9 are similar but not identical to the share exchange provisions of the MBCA and the Revised MBCA. To a degree, the Model Act gives more protection to shareholders. For example, under both the Indiana General Corporation Act and the Model Acts, only shareholders whose shares are to be acquired are entitled to vote on a share exchange.<sup>257</sup> The Model Acts, however, require that a notice of the shareholder meeting to consider the plan, including a copy or summary of the plan, must be sent to each shareholder of record whether or not entitled to vote. The Indiana Act requires only that notice be sent to those shareholders *not* entitled to vote, within five days after the plan is adopted by the shareholders.<sup>258</sup> This might be a minor point, but shareholders whose shares are not being acquired might wish to sell or otherwise dispose of their shares if they think the proposed transaction is not in their financial interest. By the time they learn of the transaction, it could be a *fait accompli* adversely affecting the value of their shares.<sup>259</sup> Not many investors will be in this position, but there is no reason why their interests should not be protected. Presumably, the Study Com-

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<sup>256</sup>31 BUS. LAW 1747, 1752 (1976). See MODEL BUSINESS CORP. ACT § 72A (1979). Sections 72A of the MBCA, and §§ 73, 74, 76-77 and 80 of the MBCA, which were amended in 1976 to conform to § 72A, are contained in chapter 11 of the Revised MBCA. REVISED MODEL BUSINESS CORP. ACT §§ 11.01-.03, 11.05-.07 (1984). Dissenters' rights which might be available to shareholders of acquired corporations are provided for in chapter 13 of the Revised MBCA. REVISED MODEL BUS. CORP. ACT §§ 13.01 to .31 (1984).

<sup>257</sup>Compare IND. CODE § 23-1-5-9(c)(1) (Supp. 1985) with MODEL BUSINESS CORP. ACT § 73 (1979) and REVISED MODEL BUSINESS CORP. ACT § 11.03(f)(2) (1984).

<sup>258</sup>Compare IND. CODE §§ 23-1-5-2(d) and -1-5-9(c) (Supp. 1985) with MODEL BUSINESS CORP. ACT § 73 (1979) and REVISED MODEL BUSINESS CORP. ACT §§ 7.05, 11.03 (1984).

<sup>259</sup>Under both statutes, neither are the shareholders of the acquiring corporation entitled to vote on the proposed exchange, nor do they have dissenters' rights. Compare IND. CODE § 23-1-5-7(a) (1982) with MODEL BUSINESS CORP. ACT § 80 (1979) and REVISED MODEL BUSINESS CORP. ACT § 13.02(a)(2) (1984).

mission will choose to track more closely the provisions of the Revised MBCA in this regard.

There appears to be a slight problem with the language of section 23-1-5-9(c)(2).<sup>260</sup> This provision states the agreement of exchange is "adopted upon receiving affirmative votes."<sup>261</sup> Presumably, this should read as adoption upon receiving the affirmative votes of a majority of the class of shares whose shares are being acquired, and a majority of the shares of each class if more than one class is being acquired.<sup>262</sup> This would track the language of section 23-1-5-2(b) relating to approval of mergers.<sup>263</sup>

It should be noted that section 23-1-5-1(3) applies only to situations where both corporations approve the proposed transaction. It would not apply to a hostile tender offer where the respective boards of directors could never agree to terms. Section 23-1-5-9(1) specifically provides that the authorized procedures do not limit a corporation's power to acquire shares of another corporation through a voluntary exchange or otherwise by agreement of the shareholders.<sup>264</sup>

All in all, the goal of simplifying the procedures for a share exchange is laudable. The apparent drafting error concerning shareholder approval should be remedied by the General Assembly, but this will not be necessary if the Corporation Law Study Commission proposes that Indiana adopt the Revised MBCA. Of course, there remains the question of whether the new procedures would be available for corporations organized after July 1, 1978.

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<sup>260</sup>IND. CODE § 23-1-5-9(c)(2) (Supp. 1985).

<sup>261</sup>*Id.*

<sup>262</sup>The model acts require approval by a majority vote, or even greater than a majority if required by the articles of incorporation or specified by the board of directors. MODEL BUSINESS CORP. ACT § 73 (1979); REVISED MODEL BUSINESS CORP. ACT § 11.03(e) (1984).

<sup>263</sup>IND. CODE § 23-1-5-2(b) (1982). Of course, if § 23-1-5-9(c)(2) really means that a plan is adopted upon receipt of at least two affirmative votes, it is highly unlikely that the agreement would be reaffirmed by the directors of each corporation as required by § 23-1-5-9(f). Presumably, the number of dissenting shareholders wishing to exercise dissenters' rights would make the deal uneconomical.

<sup>264</sup>*Compare* IND. CODE § 23-1-5-9(j) (Supp. 1985) *with* MODEL BUSINESS CORP. ACT § 72A (1979) *and* REVISED MODEL BUSINESS CORP. ACT § 11.02(d) (1984).