

Developments in Business Association Law

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I. FOREIGN LIMITED PARTNERSHIPS

The Indiana Uniform Limited Partnership Act (ULPA)¹ is the original version of the ULPA promulgated in 1916. One of the great weaknesses of the ULPA was that it did not deal with limited partnerships with multistate operations. This is not surprising considering that the drafters of the act contemplated that limited partnerships would be small, local enterprises. Times change, and limited partnerships with multistate operations have become common. Consequently, one of the great advances of the Revised Uniform Limited Partnership Act (1976) (RULPA)² and its successor, the Uniform Limited Partnership Act (1985) (ULPA 1985),³ is that they clarify the status of foreign limited partnerships.⁴ A few states had enacted procedures for recognizing foreign limited partnerships before RULPA,⁵ and some courts recognized such enterprises by applying choice of law rules.⁶ This practice, however, was not universal. This presented the risk of a court holding that a certificate of limited partnership filed in another state was not "substantial compliance" with the formalities of forming a limited partnership under ULPA.⁷ The venture would then be considered a general partnership, subjecting the limited partners to unlimited liability.⁸ Consequently, a cautious attorney representing a limited partnership formed under the laws of another state that wishes to transact business in Indiana would qualify it as an Indiana

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¹IND. CODE §§ 23-4-2-1 to -31 (1982).

²REVISED UNIFORM LIMITED PARTNERSHIP ACT, 6 U.L.A. 215 (Supp. 1986).

³UNIFORM LIMITED PARTNERSHIP ACT, 6 U.L.A. 285 (Supp. 1986).

⁴See generally Sell, *An Examination of Articles 3, 4 and 9 of the Revised Uniform Limited Partnership Act*, 9 ST. MARY'S L.J. 459, 471-77 (1978).

⁵See, e.g., CAL. CORP. CODE § 15700 (Deering Supp. 1974); TEX. REV. CIV. STAT. ANN., art. 6132a, § 32 (Vernon Supp. 1986).

⁶See, e.g., *Cheyenne Oil Corp. v. Oil & Gas Ventures, Inc.*, 42 Del. Ch. 100, 105, 204 A.2d 743, 746 (1964); *Gilman Paint & Varnish Co. v. Legum*, 197 Md. 665, 668, 80 A.2d 906, 907-08 (1951); *King v. Sarria*, 69 N.Y. 24, 30-31 (1877); see also *Plaza Realty Investors v. Bailey*, 484 F. Supp. 335 (S.D.N.Y. 1979) (New York federal court applied Indiana law to an Indiana limited partnership in a diversity action); *Partnership Equities, Inc. v. Marten*, 15 Mass. App. 42, 443 N.E.2d 134 (1982). See generally J. CRANE & A. BROMBERG, *LAW OF PARTNERSHIP* § 26 n.30 (1968).

⁷IND. CODE § 23-4-2-2(2) (1982). See generally J. CRANE & A. BROMBERG, *supra* note 6, § 26(b); H. HENN & J. ALEXANDER, *LAW OF CORPORATIONS* § 29 (3d ed. 1983).

⁸See *Arrow Petroleum Co. v. Ames*, 128 Ind. App. 10, 142 N.E.2d 479 (1957).

limited partnership under the ULPA—at least, that is, until Indiana adopts the ULPA 1985.

The only Indiana decision involving the limited liability of a foreign limited partnership is the recent decision in *Radio Picture Show Partnership v. Exclusive International Pictures*.⁹ Perhaps a more accurate statement would be that *Radio Picture Show* might have involved the limited liability status of a foreign limited partnership. A purported Texas limited partnership, 3622 Limited, was one of the entities found liable in the case.¹⁰ In turn, 3622 Limited was the purported limited partner in Radio Picture Show Partnership, which was a purported California limited partnership. The court refused to limit 3622 Limited's liability, pointing out that not only had the venture not filed a certificate of limited partnership in Indiana but also that defendants had not presented evidence they were properly formed limited partnerships in their respective states of organization.¹¹ The only evidence presented by defendants was the bare characterization by one of the parties that 3622 Limited was a limited partnership. This assertion was not sufficient to meet defendants' burden of proof on the issue.¹²

It might be possible for a foreign limited partnership planning to transact business in Indiana simply to file a copy of the certificate of limited partnership prepared and filed in its state of organization. However, because ULPA requires the certificate to specify the location of the principal place of business in Indiana in order to determine where the certificate should be filed,¹³ the only safe procedure is to prepare and file a certificate specifically drafted to comply with the Indiana ULPA. This is a very cumbersome procedure if a limited partnership does business in many states because the provisions for organizing limited partnerships in ULPA jurisdictions are not completely uniform. The problem is compounded by the frequent need to amend limited partnership certificates.¹⁴ The multiple filing requirements for multistate limited partnerships were simplified significantly in the RULPA and the ULPA 1985.¹⁵

⁹482 N.E.2d 1159 (Ind. Ct. App. 1985).

¹⁰*Id.* at 1168.

¹¹*Id.*

¹²*Id.* at 1168-69. The limitation on liability of limited partners is a matter of defense. See *Howard v. Gray's Warehouses, Inc.*, 242 Ky. 501, 46 S.W.2d 787 (1932).

The *Radio Picture Show* court stated that "a limited partnership [sic] is not a proper party in a proceeding against the partnership" under IND. CODE § 23-4-2-26. 482 N.E.2d at 1168. The reference should have been to a "limited partner," but the error is understandable because the purported limited partner, 3622 Limited, was itself a limited partnership.

¹³IND. CODE § 23-4-2-2(1) (1982).

¹⁴*Id.* § 23-4-2-24.

¹⁵REVISED UNIFORM LIMITED PARTNERSHIP ACT § 902, 6 U.L.A. 267 (Supp. 1986); UNIFORM LIMITED PARTNERSHIP ACT § 902, 6 U.L.A. 296-97 (Supp. 1986).

There is no Indiana authority on point,¹⁶ but it is clear that a foreign corporation that is the general partner of a foreign limited partnership doing business in Indiana must qualify to transact business as a foreign corporation under the Indiana General Corporation Act (IGCA).¹⁷ This is not necessary if a foreign corporation is a limited partner of a foreign, or even an Indiana, limited partnership. The requirement that limited partners not partake in control of the business to maintain limited liability status¹⁸ in effect precludes a corporation that is a limited partner from transacting business in the state. Presumably a foreign corporation that is a limited partner partaking in control of the business of a limited partnership would be subject to sanctions for failing to qualify to do business in Indiana under the IGCA¹⁹ and would be liable to creditors of the limited partnership under the ULPA.²⁰

II. CORPORATE MANAGEMENT AND SHAREHOLDER SUITS

A rather unusual case decided during the survey period is *Scott v. Anderson Newspapers, Inc.*²¹ In *Scott*, the court affirmed in part, reversed in part, and remanded with instructions certain holdings of the Hancock Superior Court in a declaratory judgment action.²² In reaching this result, the *Scott* court appeared to follow traditional corporate law maxims to some degree while doing violence to other maxims.

The dispute was between two factions in Anderson Newspapers, Inc. (ANI), which publishes the two newspapers in Anderson, Indiana, the *Bulletin* and the *Herald*. The plaintiffs represented the *Herald* group and the defendants represented the *Bulletin* group. The two newspapers were owned and operated by separate corporations before 1949, but were consolidated in that year. ANI was the corporation resulting from

¹⁶The issue was not discussed in *Radio Picture Show*, although the general partner in the partnership was a California corporation. 482 N.E.2d at 1162. The structure of the Radio Picture Show enterprise was rather complex, which could explain why the court observed that "no argument . . . [was] made concerning knotty problems of what law would govern." *Id.* at 1168.

¹⁷See IND. CODE § 23-1-11-1 (1982). See generally Note, *The Corporation as Managing Partner in a Limited Partnership*, 55 N.D.L. REV. 271 (1979). This also will be true under the new Indiana Business Corporation Law, IND. CODE § 23-1-49-1 (Supp. 1986).

¹⁸IND. CODE § 23-4-2-7 (1982). See *Port Arthur Trust Co. v. Muldrow*, 155 Tex. 612, 291 S.W.2d 312 (1956).

¹⁹IND. CODE § 23-1-11-14 (1982).

²⁰*Cf. Mursor Builders, Inc. v. Crown Mountain Apartment Ass'n*, 467 F. Supp. 1316 (D.V.I. 1978).

²¹477 N.E.2d 553 (Ind. Ct. App. 1985).

²²*Id.* at 556. Perhaps the result is not too surprising considering the somewhat convoluted nature of the parties. Defendants in the action had filed a counter claim and both parties appealed from the lower court decision. Thus there were plaintiffs, counter-defendants, appellants, and cross-appellees on one side and defendants, counter-claimants, appellees, and cross-appellants on the other. *Id.*

the consolidation.²³ The former *Herald* interests became minority shareholders and directors of ANI following the consolidation.²⁴ Each group nominated its own directors although they were elected by all ANI shareholders. In turn, the president and secretary were elected from the *Bulletin* group and the vice president from the *Herald* group. Each group appointed the editor of its own newspaper.²⁵ Satisfactory relations between the two groups apparently ended in 1981 when the founder of the *Herald*, who was the ANI vice president, died. His son voluntarily assumed the editorship of the *Herald* without any action by the ANI board.

At this point, the *Bulletin* group, armed with a legal opinion, attempted to gain complete control of ANI's affairs including the selection of the vice president, who had traditionally come from the *Herald* group; the right to nominate and elect the three *Herald* directors; and the right to name the *Herald's* editor. They offered amendments to ANI's "articles of consolidation" and bylaws to provide that all corporate business and affairs could be transacted by a simple majority vote of the shareholders or directors. The declaratory judgment suit followed because these amendments would have effectively ended the rights of the *Herald* group in ANI.²⁶

The *Scott* court, in discussing the issues in the case, consistently referred to the "Herald group's preemptive right to publish the Herald."²⁷ This terminology is unfortunate. It is not clear from the opinion whether ANI shareholders had "preemptive rights" as authorized by the IGCA.²⁸ The term preemptive rights refers to the right of shareholders to subscribe to or purchase additional shares of a corporation under certain circumstances.²⁹ It would not be surprising if ANI shareholders had preemptive rights because they are quite common in closely held corporations.³⁰ Perhaps the parties in *Scott* referred to the right of each group to publish its own newspaper as a "preemptive right," but the court should have refrained from using a term of art of corporation law in such an inaccurate fashion.

²³*Scott*, 477 N.E.2d at 557. See IND. CODE §§ 23-1-5-1, -3 (1982). See generally H. HENN & J. ALEXANDER, *supra* note 7, § 346.

²⁴*Scott*, 477 N.E.2d at 557. Initially there were five ANI directors, three from the *Bulletin* group and two from the *Herald* group. The number of directors was raised to seven, with four from the *Bulletin* group and three from the *Herald* group. *Id.*

²⁵*Id.*

²⁶*Id.*

²⁷*Id.*

²⁸IND. CODE § 23-1-2-6(i) (1982).

²⁹See generally H. HENN & J. ALEXANDER, *supra* note 7, §§ 127, 175.

³⁰Under the IGCA, shareholders do not have preemptive rights except to the extent that such rights are provided for in the articles of incorporation or a resolution of the board of directors. IND. CODE § 23-1-2-6(i) (1982).

The *Scott* court had to examine the original consolidation of the two newspapers to determine the rights of the two groups. The court started with the truism that corporations "can be created and exist only by virtue of statutory authority, and by that authority alone,"³¹ and that while "there may be a contract among individuals to enter into a corporation; . . . when the contemplated corporations [sic] comes into existence, the charter, not the contract, determines their rights. Its provisions are supreme."³²

The latter observation is overbroad. Certainly corporations are creatures of statutes, but many courts have long departed from the strict corporate norm. They now clearly recognize and enforce contracts among the parties to closely held corporations as to how the corporation is to be governed if the interests of third parties are not adversely affected.³³ This contemporary view of the corporate norm clearly has been accepted in Indiana by decisions recognizing the highly fiduciary nature of the so called incorporated partnership.³⁴ The *Scott* court recognized that the relationship between a corporation and its shareholders is a "contract in which the articles of incorporation, bylaws, provisions of the stock certificate, and the pertinent statutes are embodied,"³⁵ but it failed to acknowledge that the contract is in fact more inclusive. This narrow view did not have any impact on the result in *Scott*, but it is unfortunate that the court intentionally or inadvertently seems to be retreating from the view of the contemporary cases.

The *Scott* court correctly characterized the articles of consolidation as ANI's articles of incorporation.³⁶ Thus, it was appropriate to look to the articles of consolidation to determine the rights of the two disputing groups with respect to the *Herald*. The court was satisfied that the provisions of the articles made it clear that the two newspapers were to be controlled by their respective groups. This arrangement included

³¹*Scott*, 477 N.E.2d at 558. See *Ohio Ins. Co. v. Nunnemacher*, 15 Ind. 294 (1860); *Indiana Bond Co. v. Ogle*, 22 Ind. App. 593, 54 N.E. 407 (1899). See generally H. HENN & J. ALEXANDER, *supra* note 7, § 78.

³²*Scott*, 477 N.E.2d at 558.

³³See, e.g., *Galler v. Galler*, 32 Ill. 2d 16, 203 N.E.2d 577 (1964); *McQuade v. Stoneham*, 263 N.Y. 323, 189 N.E. 234 (1934).

³⁴See *Dotlich v. Dotlich*, 475 N.E.2d 331 (Ind. Ct. App. 1985), discussed in Galanti, *Business Law, 1985 Survey of Recent Developments in Indiana Law*, 19 IND. L. REV. 67, 82-88 (1986); *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).

³⁵477 N.E.2d at 558.

³⁶*Id.* at 559. See IND. CODE § 23-1-5-5(f) (1982).

not only the right to maintain separate editorial policies but also that the shareholders and directors of one group would not interfere with the operation of the other newspaper.³⁷ No fault can be found with this conclusion, although the choice of the term "preemptive right" was unfortunate.

The *Scott* court's treatment of ANI's bylaws was somewhat inconsistent with its emphasis on the primacy of the articles of consolidation. The bylaws, adopted shortly after ANI was organized, provided in part that provisions relating to the proportion of directors from each group and the right of each group to fill board vacancies were not to "be changed except by the affirmative vote of six-eighths of all outstanding stock of this corporation."³⁸ The court gave effect to this bylaw, as it should have, although under the IGCA, any provision requiring a greater than majority vote for shareholder action must be included in the articles of incorporation.³⁹ The IGCA permits the bylaws to establish the quorum of outstanding shares for a meeting of shareholders.⁴⁰ There is nothing wrong with giving effect to the bylaw, particularly because both groups substantially complied with the bylaw until the present litigation,⁴¹ although the result is inconsistent with the court's expressed understanding of the requirements of Indiana corporation law.⁴²

The court next considered the contention of the *Bulletin* group that a simple majority vote could amend the articles to eliminate these provisions. The *Bulletin* group argued that the phrase "without limi-

³⁷*Scott*, 477 N.E.2d at 559-60.

³⁸*Id.* at 560.

³⁹IND. CODE § 23-1-2-9(m) (Supp. 1986).

⁴⁰*Id.* § 23-1-2-9(n). Presumably the bylaws were adopted by the shareholders acting as shareholders rather than by the directors. Under the IGCA, the power to make, alter, amend, or repeal bylaws is vested in the board of directors unless otherwise provided in the articles of incorporation. *Id.* § 23-1-2-8.

Either the ANI articles of consolidation vested authority in the shareholders with respect to the bylaws, or at least provided that with respect to the composition of the board, any change would require shareholder approval with a high enough vote that no change could occur unless both factions agreed. This would be permissible under Indiana Code section 23-1-2-8 although the greater than majority voting requirement should have appeared in the articles of incorporation.

It is possible the articles of consolidation did require a greater than majority vote for shareholder action and this simply was not mentioned by the court. This does seem unlikely, however, because the court substantially set out the provision in the articles of consolidation relating to the make up of the board of directors. *Scott*, 477 N.E.2d at 559-60.

⁴¹*Scott*, 477 N.E.2d at 560.

⁴²There is an old Indiana decision, *Green v. Felton*, 42 Ind. App. 675, 84 N.E. 166 (1908), holding that a bylaw providing that bylaws could be amended by a two-thirds vote required a vote of two-thirds shares represented at a meeting rather than a vote of two-thirds of all shares. However, *Green* was decided before the IGCA was adopted.

tation” contained in the IGCA provision⁴³ relating to amending articles of incorporation meant that a simple majority could amend the articles regardless of any other provisions in the corporate documents. This is clearly erroneous. Certainly, the articles of consolidation *could* be amended under the IGCA to give the *Bulletin* group total control of both papers. However, the problem is not the possible absence of a provision in the articles requiring a greater than majority vote of shareholders to amend the articles, but that the operating terms of the articles prohibited either group even from taking steps to propose an amendment to the articles. Thus, the *Scott* court was right in concluding that the provisions in the articles relating to control over each newspaper could be amended only if the directors or shareholders of the group concurred.⁴⁴

The court characterized the *Bulletin* group’s proposal to eliminate the rights of the *Herald* group as “ultra vires.”⁴⁵ The ultra vires doctrine is severely limited by the IGCA, but in some cases it can be raised by a shareholder.⁴⁶ The court unfortunately misused the term “ultra vires,” which should be limited to situations where a corporation has attempted to do something not authorized by its purposes or powers. ANI did not lack capacity to do what the *Bulletin* group wanted. Rather, the *Bulletin* group was trying to do something in an improper manner. Furthermore, characterizing the *Bulletin* group’s efforts as ultra vires is totally inconsistent with the court’s determination that the *Scott* action was a derivative rather than a direct action. An action by a shareholder to enjoin an ultra vires act would be an action brought to enforce a right of the shareholder rather than a right of a corporation. The latter is the essence of a shareholder derivative action.⁴⁷

The court rejected the *Bulletin* group’s contention that Indiana law does not provide for separate approval of amendments by shareholder “groups” where the corporation has a single class of shares.⁴⁸ The court’s approach to this issue is intriguing. It relied on the “import”

⁴³IND. CODE § 23-1-4-1(a) (Supp. 1986).

⁴⁴It is possible that the opinion of the *Bulletin* group that they could amend the articles by a simple majority was premised on the lack of a greater than majority voting requirement provision in the articles of consolidation. It is clear that a better drafting job would have included such a provision in the articles. The argument of the *Bulletin* group, of course, was not specious and could have been accepted by the *Scott* court with its somewhat misbegotten emphasis on the controlling nature of the corporation statute over corporate conduct.

⁴⁵477 N.E.2d at 561.

⁴⁶See IND. CODE § 23-1-10-4(a) (1982). See generally W. CARY & M. EISENBERG, CASES AND MATERIALS ON CORPORATIONS 40 (5th ed. unabr. 1980); H. HENN & J. ALEXANDER, *supra* note 7, § 184.

⁴⁷See generally H. HENN & J. ALEXANDER, *supra* note 7, § 360.

⁴⁸*Scott*, 477 N.E.2d at 561-62.

of the IGCA section authorizing provisions in articles "creating, defining, limiting or restricting the powers . . . , of the shareholders of any class . . . of shareholders."⁴⁹ The court apparently rejected the idea that there was more than one class of shares while at the same time recognizing the *Herald* interests and the *Bulletin* interests as separate "groups."⁵⁰ The court concluded the statement that there was "no division" of the shares in the printed articles of consolidation prescribed by the Indiana Secretary of State simply meant that there was only one class of shares so that no statement of voting rights was required because there was only one class. The court in effect treated the two groups as separate classes while denying that it was doing this because the arrangement was not sanctioned in the articles of consolidation.

There is nothing wrong with rejecting the *Bulletin* group's argument, and the court reached the right result. However, if the court had been willing to depart from its preternatural position that the "contract" to be construed was within the four corners of the articles of consolidation and simply gave effect to the obvious intent of the parties, as was done in *Cressy v. Shannon Continental Corp.*,⁵¹ the same result could have been reached in a less circuitous way.

One of the most questionable aspects of the *Scott* decision was the court's determination that the suit was a derivative action warranting recovery of attorney's fees and expenses by the *Herald* group.⁵² The *Bulletin* group argued unsuccessfully that the action was personal to the plaintiffs because it sought to protect and defend their rights as shareholders and did not seek relief benefiting the corporations. The court responded that "[i]t is only in exceptional cases that stockholders will be permitted to sue or defend a suit for and on behalf of themselves as stockholders of such corporation."⁵³ This statement is absolutely extraordinary in light of the court's own characterization of the *Bulletin* group as "illegally and oppressively pursuing a course of action in the name of the corporation calculated to destroy the *Herald* group's"⁵⁴ interests. There is no simple and foolproof method for distinguishing a derivative action from a shareholder's direct or individual action.⁵⁵ Gen-

⁴⁹*Id.* at 562 (emphasis in original) (quoting IND. CODE § 23-1-3-2(12) (1982)).

⁵⁰*Id.* A better way of handling this issue when ANI was organized would have been to create two classes of shares: a *Herald* class and a *Bulletin* class. This is a very effective way to insure that each constituent group in a corporation will have its interests protected. See *Lehrman v. Cohen*, 43 Del. Ch. 222, 222 A.2d 800 (1966).

⁵¹177 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).

⁵²477 N.E.2d at 562-64.

⁵³*Id.* at 563.

⁵⁴*Id.*

⁵⁵H. HENN & J. ALEXANDER, *supra* note 7, § 360.

erally speaking, however, "the breach of the shareholder's membership contract give[s] rise to a *direct or individual* action while a wrong to the incorporated group as a whole (i.e. breach of some duty to the corporation) is the basis for derivative action."⁵⁶ The derivative action is appropriate to recover damages or profits where a controlling interest is harming the corporation,⁵⁷ but whatever harm the *Bulletin* group was causing was to the *Herald* group and not to ANI. Furthermore, derivative actions are constrained by the provisions of trial rule 23.1.⁵⁸ There was no evidence that plaintiffs complied with these requirements, or at least none was mentioned by the court.

Furthermore, the court in discussing the ultra vires issue recognized that the action may be brought in a proceeding "against the corporation."⁵⁹ The derivative action, of course, is an action on behalf of the corporation. The court in fact stated that suits for and on behalf of shareholders as shareholders are permitted "where a majority of the stockholders are illegally and oppressively pursuing a course in the name of the corporation, which is in violation of the right of the other stockholders, and can only be restrained by a court of equity."⁶⁰ It is clear that if the *Scott* litigation can be characterized as anything, it can be characterized as an attempt by the *Bulletin* group to oppress the *Herald* group. Despite reaching this conclusion, the court determined that the action was derivative. The position taken in *Scott* is supported by neither Indiana nor general authority.

It is possible the court characterized the action as a derivative suit to uphold the order that ANI pay the *Herald* group's costs and attorneys' fees.⁶¹ It is well settled that attorneys' fees and expenses can be awarded to a successful plaintiff in a shareholder derivative suit under Indiana law.⁶² This approach is the converse of the not uncommon situation of a court straining to characterize an action as direct rather than derivative

⁵⁶*Id.* (emphasis added). Henn and Alexander have noted that among other things, the following have been held to be direct actions by shareholders: (1) suits to protect preemptive rights (presumably referring to the traditional preemptive right to subscribe to shares of the corporation, rather than as the term is used in *Scott*); (2) suits to enforce the right to vote; (3) suits to enjoin an ultra vires act or other threatened wrong before its consummation; (4) suits for breach of a shareholder agreement. *Id.*

⁵⁷*Id.*

⁵⁸IND. R. TR. P. 23.1.

⁵⁹*Scott*, 477 N.E.2d at 561 n.2.

⁶⁰*Id.* at 563 (citing *McFarland v. Pierce*, 151 Ind. 546, 45 N.E. 706 (1897), *reh'g overruled*, 151 Ind. 549, 47 N.E. 1 (1897)).

⁶¹*Id.* at 564. The fees and expenses awarded totaled \$122,818.82. *Id.*

⁶²See *Neese v. Richer*, 428 N.E.2d 36 (Ind. Ct. App. 1981), *discussed in Galanti, Business Associations, 1982 Survey of Recent Developments in Indiana Law*, 16 IND. L. REV. 25, 25-29 (1983); *see also Cole Real Estate Corp. v. Peoples Bank & Trust Co.*, 160 Ind. App. 88, 310 N.E.2d 275 (1974).

where an unsuccessful shareholder in a derivative action can be liable for the expenses of the corporation under a security for expenses statute.⁶³ Still, a well intentioned motive of making a corporation bear the expenses of litigation does not justify characterizing a direct shareholder action as a derivative action.

The court next rejected the *Bulletin* group's argument that ANI should recover the salary paid plaintiff Scott for his services as interim editor of the *Herald* until he was removed from that position by court order.⁶⁴ The court concluded that the trial court was justified in rejecting the argument that Scott was an "officious intermeddler" and in concluding that there was an implied contract between ANI and Scott because someone had to be the editor of the *Herald*.⁶⁵

The final issue considered in *Scott* was whether the *Herald* group's directors had the right to name the ANI vice president.⁶⁶ The ANI vice president apparently had come from the *Herald* group from the time ANI was organized in 1949 to the death of Scott's father in 1981. The *Herald* group argued that this history impliedly amended the articles of consolidation and the bylaws to provide in effect that the ANI vice president would come from the *Herald* group. The court rejected this argument and noted that the *Herald* group cited "no Indiana cases supporting that contention, only cases from foreign jurisdictions so stating."⁶⁷ This too is an extraordinary statement. It is well established that relationships, even if reflected in corporate documents, can be impliedly amended by the conduct of the parties if the interests of third parties are not harmed.⁶⁸ The fact that no Indiana case had so held simply means that the issue had not previously arisen in Indiana. Interestingly the court did not cite any Indiana cases holding that this cannot be done.

The court noted that the *Herald* group made no attempt to show the corporation laws of the states from which the cases arose were

⁶³See, e.g., *Reifsnnyder v. Pittsburgh Outdoor Advertising Co.*, 405 Pa. 142, 173 A.2d 319 (1961). See generally H. HENN & J. ALEXANDER, *supra* note 7, § 372.

⁶⁴*Scott*, 477 N.E.2d at 564-65.

⁶⁵*Id.* The court also declined to order Scott to reimburse the corporation for telephone calls charged to and paid by ANI. The argument that the calls were personal was rejected because the calls were related to the litigation. Although the court's determination that the cost of the litigation should be assessed against ANI might be questionable, it certainly follows that these expenses were properly considered costs of the litigation. If Scott had been ordered to repay the corporation, he could then petition the court to order the corporation to reimburse him in the same amount. *Id.* at 565.

⁶⁶*Id.* at 565.

⁶⁷*Id.*

⁶⁸See, e.g., *Magnus v. Magnus Organ Corp.*, 71 N.J. Super. 363, 177 A.2d 55 (1962). Compare *Galler v. Galler*, 32 Ill. 2d 16, 203 N.E.2d 577 (1964) with *Somers v. AAA Temporary Serv., Inc.*, 5 Ill. App. 3d 931, 284 N.E.2d 462 (1972).

substantially the same as Indiana corporation law.⁶⁹ Although the plaintiffs might have been well advised to have checked those statutes, citing such authority should not have been necessary because this is a general principle of corporate law, which exists apart from statutes. The *Scott* court also ignored the fact that Indiana courts have recognized the estoppel doctrine. In *Bossert v. Geis*,⁷⁰ the court held that a corporation was estopped by long continued conduct of its president, with its implied knowledge and consent, from denying his authority to execute contracts and borrow money, though not expressly authorized by articles, bylaws, or the directors. This rationale should have applied in *Scott*, or at least it should have been considered by the court.

As it is, the court concluded that because ANI's charter, meaning the articles of consolidation, did not spell out "a preemptive right" for the *Herald* group to name the vice president, "it does not exist. ANI officers may be nominated by any director, come from any group, and be elected by simple majority vote of the ANI directors."⁷¹ In other words, the *Herald* group could name the newspaper's editors but they were forever a minority block on the board with very little influence on the day to day operations of ANI as a corporation. This result is both unfortunate and unnecessary. It is fairly certain the parties who formed ANI contemplated that the vice president would come from the *Herald* group, and it is also clear that the most effective way of insuring that each group would have rights with respect to its own paper was to have one of the ANI officer positions filled by the *Herald* group.

All in all, the opinion in *Scott v. Anderson Newspapers, Inc.* strikes this author as unfortunate. This is not so much for the result, because the *Bulletin* group certainly was interfering with the intended structure of ANI. Rather, it is because of the court's unnecessary and improper use of the term "preemptive rights," and its insistence on staying within the four corners of the articles of consolidation notwithstanding other decisions of the Indiana Court of Appeals that have recognized the highly fiduciary nature of the relationships among owners of closely held corporations.⁷² Hopefully, if a similar dispute occurs before another district, the analysis of *Scott* will not be followed, and the fourth district will reconsider the views expressed in *Scott* if another opportunity arises.⁷³

III. CORPORATE CONTROL

The attempt by Dynamics Corporation of America (DCA) to obtain control of CTS Corporation has become a prolific source of legal issues

⁶⁹*Scott*, 477 N.E.2d at 565.

⁷⁰57 Ind. App. 384, 107 N.E. 95 (1914).

⁷¹*Scott*, 477 N.E.2d at 565.

⁷²See cases cited *supra* note 34.

⁷³The battle between the ANI factions continues. Most recently there appears to be

and judicial decisions. The battle took place in both state and federal courts. DCA failed in its effort to oust the incumbent CTS management, but the biggest loser as of this writing is the new Indiana Business Corporation Law (IBCL) or, more specifically, the control share acquisition chapter of the IBCL.⁷⁴

All told there have been five opinions in the control battle: one in state court,⁷⁵ three in the United States District Court for the Northern District of Illinois,⁷⁶ and one in the Seventh Circuit Court of Appeals.⁷⁷ There will be at least one more because the United States Supreme Court will hear an appeal from the Seventh Circuit decision.⁷⁸ The Indiana action involved the issue of DCA's right as a substantial shareholder to obtain corporate information from CTS. The federal litigation involved DCA's challenge to the defensive moves by CTS's management.

Anyone who opposes attempts to acquire or obtain control of Indiana corporations will be pleased by the result in *DCA I*, which for all intents and purposes blocks offerors or insurgents' from access to corporate books and records under the record keeping provisions of the Indiana General Corporation Act (IGCA).⁷⁹ Theoretically they can still gain access to the records as shareholders if they can persuade a local court that they have a "proper purpose" for seeking disclosure of corporate information, and *DCA I* does not on its face impose on the shareholder the burden of establishing proper purpose.⁸⁰ However, by taking an extraordinarily narrow view of what is a proper purpose, the result of *DCA I* is tantamount to putting the burden on the shareholder.

In *DCA I*,⁸¹ the Indiana Court of Appeals affirmed an order of the Elkhart Circuit Court denying relief to DCA in its mandamus action to compel CTS to disclose corporate information.⁸² The court stated that the trial court could infer that this information was not sought for

some question as to who owns ANI. It was reported that the two newspapers may have been sold to a newspaper chain, but this was denied by the president of ANI. Indianapolis Star, Oct. 31, 1986, at 35, col. 2.

⁷⁴IND. CODE §§ 23-1-42-1 to -11 (Supp. 1986).

⁷⁵Dynamics Corp. of America v. CTS Corp., 479 N.E.2d 1352 (Ind. Ct. App. 1985) [*DCA I*].

⁷⁶Dynamics Corp. of America v. CTS Corp., 637 F. Supp. 406 (N.D. Ill. 1986) [*DCA II*]; Dynamics Corp. of America v. CTS Corp., 635 F. Supp. 1174 (N.D. Ill. 1986) [*DCA III*]; Dynamics Corp. of America v. CTS Corp., Fed. Sec. L. Rep. (CCH) ¶ 92,765 (N.D. Ill. May 3, 1986) [*DCA IV*].

⁷⁷Dynamics Corp. of America v. CTS Corp., 794 F.2d 250 (7th Cir.), *prob. juris. noted*, 107 S. Ct. 258 (1986) [*DCA V*].

⁷⁸107 S. Ct. 258 (Oct. 6, 1986) (noting probable jurisdiction for appeal).

⁷⁹IND. CODE § 23-1-2-14 (1982).

⁸⁰*DCA I*, 479 N.E.2d at 1353. In fact it seems to take the position that the burden is on management to prove a lack of a proper purpose. *Id.* n.2.

⁸¹479 N.E.2d 1352 (Ind. Ct. App. 1985).

⁸²*Id.* at 1353.

a proper purpose but rather to assist DCA in its non-derivative battle against incumbent management for control of CTS.⁸³ This does not mean, however, that steps taken to oust incumbent management were adverse to the best interests of the corporation.

The particular litigation was instituted in 1981 after DCA had demanded to inspect numerous CTS records. It appears that some of the requested information had been furnished to DCA as a result of discovery in pending litigation or had been furnished to all CTS shareholders. Apparently DCA filed the mandamus action before CTS had formally responded to its request, but it is certainly disingenuous to think that considering the hostility between DCA and CTS management, CTS would have produced the requested records without a court order.⁸⁴

DCA I treated the burden of proof issue in suits to enforce a shareholder's inspection rights in a summary fashion. Apparently the trial court had made a preliminary ruling that the IGCA required DCA to state its purposes in seeking to inspect CTS's books and records before it could sue, and that it had the burden of proving that those purposes were proper.⁸⁵ The court of appeals indicated that it was "inclined" to the view that Indiana authority as reflected in *Charles Hegewald Co. v. State*⁸⁶ supported the position of the trial court, but that any error was "harmless" because the court's findings clearly imposed the burden on CTS.⁸⁷ It certainly is possible that the trial court did impose the burden on CTS and that its preliminary rulings were just that, but it does appear that the *DCA I* court gave *Hegewald* an unduly narrow reading. *Hegewald* requires the purpose of the examination to be germane to the shareholder's interest as a shareholder, but the Indiana Supreme Court was not clearly departing from the position taken by other courts that impose the burden of establishing a *lack* of proper purpose on the corporation.⁸⁸ Furthermore, nothing in *Hegewald* actually requires a shareholder to state his purposes in seeking inspection before filing a mandamus action,⁸⁹ and the IGCA is silent on this point.⁹⁰

⁸³*Id.* at 1355.

⁸⁴*See id.* at 1354-55. The fact that the shareholder already has available the information being sought might be grounds for denying inspection under common law for lack of good faith. *See People ex rel. Giles v. Klauder-Weldon Dyeing Mach. Co.*, 180 A.D. 149, 167 N.Y.S. 429 (1917). *See generally* H. HENN & J. ALEXANDER, *supra* note 7, § 199.

⁸⁵*DCA I*, 479 N.E.2d at 1353 n.2.

⁸⁶196 Ind. 600, 149 N.E. 170 (1925).

⁸⁷479 N.E.2d at 1353 n.2.

⁸⁸*Hegewald*, 196 Ind. at 605-06, 149 N.E. at 173. *See generally* H. HENN & J. ALEXANDER, *supra* note 7, § 199 n.2.

⁸⁹Failure to state the purpose might, however, go against the good faith element of the shareholder's right to examine corporate books and records.

⁹⁰IND. CODE § 23-1-2-14 (1982).

The inspection provisions of the IBCL⁹¹ require the shareholder to disclose the purpose of the inspection before being given access to books and records. This is true even under the comparable provisions of the Revised Model Business Corporation Act,⁹² which takes a more liberal view in balancing the right of shareholders to inspect corporate records and the interest of management in freedom from harassment by shareholders.

DCA sought to inspect records and minutes of the 1981 CTS annual meeting of shareholders, books of account reflecting expenditures for research and development since 1978, books of account reflecting all legal fees paid or incurred in connection with the litigation between CTS and DCA, all fees paid or owed to an investment banking firm since 1980, and the minutes of all regular and special meetings of the board of directors of CTS since August 1980.⁹³

The *DCA I* court also relied on *S.F. Bowser & Co. v. State*.⁹⁴ *Bowser* held that mandamus would not lie unless and until the corporation knew or was given reasonable assurance that the party making a request was really a shareholder. It is difficult to see how *Bowser* supported CTS's position. CTS clearly knew DCA was a shareholder because management and DCA had been battling for several years. The court also cited the Illinois decision in *People ex rel. Miles v. Bowen Industries, Inc.*⁹⁵ This too seems of questionable import because *Miles* also involved the issue of whether the requesting party was a shareholder and entitled to inspect the corporate records under the applicable provisions of the Illinois Business Corporation Act.⁹⁶

The *DCA I* court was correct in noting that both statutory and common law require a shareholder to have a proper purpose to be entitled to inspect corporate books and records.⁹⁷ The problem with the decision is that the court seemingly required that every purpose of the shareholder be "proper." Sounder authority recognizes that a shareholder is not entitled to corporate information for purely personal or commercial reasons, but permits inspection where there is a proper purpose even

⁹¹IND. CODE § 23-1-52-2(c)(2) (Supp. 1986).

⁹²4 MODEL BUS. CORP. ACT ANN. § 16.02 (3d ed. 1985). The balance of the RMBCA is aimed at protecting management from harassment by shareholders with small holdings, which was not the case with DCA, the largest shareholder of CTS.

⁹³*DCA I*, 479 N.E.2d at 1353. The court of appeals cryptically noted that "[w]e do not suggest that all this information was discoverable under the Statute. The trial court determined that some was not." *Id.* n.3. It appears that the court applied some of the restrictions imposed by discovery rules to a shareholder's right to inspect corporate records, although there does not appear to be a basis for this.

⁹⁴192 Ind. 462, 137 N.E. 57 (1922).

⁹⁵327 Ill. App. 362, 64 N.E.2d 213 (1945).

⁹⁶ILL. REV. STAT., ch. 32, para. 157.45 (1945).

⁹⁷*DCA I*, 479 N.E.2d at 1354.

though there might be some ulterior motive.⁹⁸ Thus, even if DCA's purpose in wanting the information to aid "its non-derivative litigation and competitive goals against CTS" was improper (and this is not clearly the case), DCA had indicated the possibility of a suit against CTS management for waste of corporate assets in continuing counterclaims against DCA.⁹⁹ Utilizing corporate records as the basis of possible litigation against management has long been held to be a proper purpose.¹⁰⁰ Even if the propriety of the possible litigation was a "close call," CTS should have lost if the burden of proof was in fact on it rather than on DCA.

Furthermore, even cases that narrowly construe the right of shareholders to inspect corporate records such as *State ex rel. Pillsbury v. Honeywell, Inc.*¹⁰¹ emphasize that the shareholder's purpose must be related to his investment. Clearly DCA, which had been acquiring CTS shares since 1980, was concerned with its "investment." Consequently it seems that DCA's purpose was proper, and it is dubious to say that the trial court's finding was supported by the evidence.

The *DCA I* court also upheld the determination that DCA lacked a proper purpose in demanding disclosure of research and development expenditures of CTS.¹⁰² The decision on this point appears to hinge upon a statement by DCA's president following the 1981 CTS shareholder meeting praising "the manner in which CTS had answered the questions [about the reclassification of CTS's research and development expenses] at the meeting."¹⁰³ The court stated that DCA had given no explanation to CTS for "withdrawing its expressed approval of Mr. Hostetler's response at the annual meeting."¹⁰⁴ The court also noted that information on CTS's research and development was contained in "work papers" prepared by CTS accountants and not in a separate account and that

⁹⁸See, e.g., *State ex rel. Theile v. Cities Serv. Co.*, 31 Del. 514, 115 A. 773 (1922) (purpose to sell list improper); *General Time Corp. v. Talley Indus., Inc.*, 43 Del. Ch. 531, 240 A.2d 755 (1968) (desire to solicit proxies in opposition to management directly related to shareholder status and any secondary purpose irrelevant); *Hannahan v. Puget Sound P. & L. Co.*, 332 Mass. 586, 126 N.E.2d 499 (1955) (possible use of shareholder list for commercial purposes by securities dealer no bar to inspection). See generally H. HENN & J. ALEXANDER, *supra* note 7, § 199.

DCA clearly was attempting to oust CTS management which cannot, objectively speaking, be deemed improper harassment of management justifying denial of inspection rights. See *Sawers v. American Phenolic Corp.*, 404 Ill. 440, 89 N.E.2d 374 (1949). CTS management obviously would disagree, but they cannot be considered "objective" on this issue.

⁹⁹*DCA I*, 479 N.E.2d at 1354.

¹⁰⁰See, e.g., *Rochester v. Indiana County Gas Co.*, 246 Pa. 571, 92 A. 717 (1914).

¹⁰¹291 Minn. 322, 191 N.W.2d 406 (1971).

¹⁰²*DCA I*, 479 N.E.2d at 1355.

¹⁰³*Id.*

¹⁰⁴*Id.*

the information was considered confidential by CTS.¹⁰⁵ The use of the term "work papers" suggests that the court applied evidentiary rules and doctrines to shareholder rights to information. If DCA in fact misused any information that contained trade secrets, trade regulation law would amply protect the interests of CTS. The main point seemed to be DCA's "change of heart" on management's responses. It is an extraordinarily thin reed to support a conclusion that seeking information on expenditures for research and development is not a proper purpose simply because the shareholder or, in this case, the president of a corporate shareholder, praised a response to a question at a shareholder meeting. Certainly this cannot seriously be considered an appropriate application of the estoppel concept.

It is within the purview of a shareholder's interest to determine how the funds of the corporation are expended and whether those expenditures will produce the most appropriate return to investors.¹⁰⁶ CTS management of course believed that its decisions as to the appropriate directions for CTS research and development were correct, but this view does not preclude a shareholder from disagreeing and attempting to show that the management's efforts were ill advised.

If CTS were threatened by DCA hiring away its employees, it could protect itself by employment contracts containing covenants not to compete. Furthermore, if employment contracts were not terminable at will, CTS could have an action for inducing a breach of contract.¹⁰⁷ Even in the absence of contractual obligation, the fiduciary duty owed by an agent to a principal can act as a bar against improper conduct by a former employee.¹⁰⁸

The last item of information DCA sought related to the retention of an investment banker and the minutes of board meetings where legal advice received by CTS regarding litigation with DCA and tentative CTS business plans were discussed. The court merely listed these items and concluded that "there was a reasonable inference available to the trial court that DCA was not seeking the requested information for a 'proper purpose' but sought it instead to assist DCA in its non-derivative litigation and competitive goals against CTS."¹⁰⁹ Although this may be so, there was no analysis of why this information had no impact on the investment interests of corporate shareholders. The bald conclusion that DCA did

¹⁰⁵*Id.*

¹⁰⁶H. HENN & J. ALEXANDER, *supra* note 7, § 199.

¹⁰⁷See generally Harper, *Interference with Contractual Relations*, 47 NW. U.L. REV. 873 (1953).

¹⁰⁸See, e.g., *Duane Jones Co. v. Burke*, 281 A.D. 662, 121 N.Y.S.2d 107 (1953), *aff'd as modified*, 306 N.Y. 172, 117 N.E.2d 237 (1954).

¹⁰⁹*DCA I*, 479 N.E.2d at 1355.

not have a proper purpose is appropriate only if the burden of proving a proper purpose is on the shareholder. The lack of analysis of this issue raises the possibility that both the trial court and the court of appeals *were* putting the proper purpose burden on DCA.

The court cited numerous cases for the proposition that courts reviewing inspection statutes have adopted the general rule that the primary purpose of the inspection must not be adverse to the best interest of the corporation.¹¹⁰ This is, of course, a truism, but interestingly in one case cited by the court, inspection was granted.¹¹¹

It seems that under a decision such as *DCA I*, a "proper purpose" to entitle a shareholder to inspect corporate records is not so much in the eye of the beholder as it is in the eye of management. Certainly management of corporations that are or are perceived to be likely takeover targets will find much comfort in *DCA I*, particularly because the inspection rights of shareholders under the IGCA are broader than under the IBCL. Under the new law, a "proper purpose" is statutorily mandated and a shareholder must disclose that purpose and indicate that the request is directly connected with that purpose.¹¹² The requirement of disclosing the purpose and the nexus between the documents and the purpose could easily be satisfied by a shareholder in the position of DCA. However, with the narrow view of "proper purpose" in *DCA I*, which will still be good authority under the IBCL, the tender offeror or insurgent in a proxy contest will find a less than hospitable atmosphere in Indiana courts.

The offeror or insurgent might find the atmosphere in federal courts more hospitable, at least if the Supreme Court upholds Judge Posner's scholarly opinion in *DCA V*.¹¹³ In *DCA V*, the Seventh Circuit affirmed the decision of the United States District Court for the Northern District of Illinois in *DCA II*¹¹⁴ enjoining CTS's management from enforcing a "poison pill" plan adopted by CTS during a proxy contest between management and DCA. DCA sought injunctive relief under section 14(a) of the Securities Exchange Act of 1934,¹¹⁵ alleging an unlawful proxy solicitation by CTS management.¹¹⁶

¹¹⁰*Id.*

¹¹¹C. M. & M. Group, Inc. v. Carroll, 453 A.2d 788 (Del. 1982).

¹¹²IND. CODE § 23-1-52-2(c)(2) (Supp. 1986).

¹¹³Dynamics Corp. of America v. CTS Corp., 794 F.2d 250 (7th Cir.), *prob. juris. noted*, 107 S. Ct. 258 (1986).

¹¹⁴Dynamics Corp. of America v. CTS Corp., 637 F. Supp. 406 (N.D. Ill. 1986).

¹¹⁵15 U.S.C. § 78n(a) (1982).

¹¹⁶*DCA II*, 637 F. Supp. at 407. The day DCA filed suit, it announced a tender offer for up to one million CTS shares at \$43.00 per share and that it intended to wage a proxy contest to elect its own slate of directors to the CTS board. The offer increased DCA's holdings in CTS to 27.7% of the outstanding shares. *Id.*

DCA II involved DCA's motion for a preliminary injunction against the shareholder rights plan adopted by the CTS board shortly after DCA filed suit. The plan adopted by the CTS board gave CTS shareholders a distribution of one "right" per share. The rights had no value unless and until certain triggering events occurred. The first, known as a "flip-in," occurred when a person or group acquired fifteen percent or more of CTS's common shares. At such time, the rights became nonredeemable and entitled all CTS shareholders except the acquiror to purchase a unit of CTS securities consisting of a fractional share of common stock and debentures at a price equal to twenty-five percent of the pretrigger value of the securities. The purpose of the "flip-in" was to inflict an immediate economic loss on any hostile bidders who did not negotiate with management before making an unsolicited acquisition attempt.¹¹⁷ Perhaps it would be more accurate to say that a flip-in plan or any other defensive poison pill is intended to make the target so unpalatable that there simply will not be any unsolicited acquisitions.

The CTS rights plan also contained a "flip-over" provision which was triggered if CTS were acquired in a merger or upon the sale of all or the majority of its assets. When the flip-over provision was triggered, CTS shareholders could purchase common shares of the acquiring company worth \$150 for \$75.

The flip-in provision was in controversy in *DCA II* because DCA's tender offer would have raised its holdings above the fifteen percent trigger threshold.¹¹⁸ DCA raised numerous arguments against the CTS poison pill. It first argued that the plan established two classes of shares and discriminated among shareholders. DCA contended this was prohibited by Indiana law. It also argued that in adopting the plan in response to the DCA tender offer, CTS management breached its fiduciary duty to CTS and other shareholders.¹¹⁹

Judge Getzendanner rejected these arguments. Under both the IGCA and the IBCL, a corporation can issue "rights" that trade with shares,¹²⁰ including those owned by an acquiring corporation, even if the acquiring

¹¹⁷The rights belonging to the acquirer under the plan became null and void when the fifteen percent threshold was reached. *Id.*

¹¹⁸The court noted that according to CTS's calculations, the issuance of shares and debentures to other CTS shareholders would have imposed an economic loss of approximately \$24 million on DCA. *Id.* at 408.

¹¹⁹*Id.*

¹²⁰See IND. CODE § 23-1-2-7 (1982) (IGCA); *Id.* § 23-1-26-5 (Supp. 1986) (IBCL). The court stated that it had been "advised" that Indiana courts look to Delaware decisions in matters of corporate law. 637 F. Supp. at 408. This is somewhat of an overstatement.

Not surprisingly, CTS "opted in" to the IBCL on April 1, 1986, the earliest date at which corporations organized under the IGCA could opt in, although the plan was adopted before CTS was controlled by the IBCL.

corporation takes subsequent action that causes it to forfeit those rights. Shareholder approval would have been necessary if the plan had created a new class of shares, but the *DCA II* court appears correct in rejecting that contention. The plan was not a pure vote altering scheme¹²¹ since economic consequences attached to the rights when they were triggered. This is not to say that the law is "right." Even *The Wall Street Journal* has editorialized that "[t]here is only one way to be sure that managers and shareholders are on the same side of a takeover question—shareholders should have to vote to approve defensive tactics."¹²² Because DCA had not established a probability of success on its claim that the rights plan was not authorized under Indiana law, it was not entitled to a preliminary injunction.¹²³

The court also rejected the argument that the rights plan discriminated against DCA and any other CTS shareholders who might acquire over fifteen percent of CTS's outstanding shares.¹²⁴ The court relied on *Unocal Corp. v. Mesa Petroleum Co.*,¹²⁵ where the Delaware Supreme Court upheld a Unocal exchange offer for its own shares that intentionally excluded shares owned by Mesa because Unocal was responding to a perceived threat presented by Mesa. *Unocal* and *Moran v. Household International, Inc.*¹²⁶ applied the business judgment rule to the adoption of defensive moves against hostile offerors and so basically supported the position of DCA. However, even assuming that *Unocal* and *Moran* did not tilt the playing field between target managers and raiders unduly in favor of the former, the *DCA II* court felt that the Delaware standards had not been met by CTS's management, which seemed more inclined to entrench itself than to protect the interest of CTS shareholders.¹²⁷ Even though the actions of a board are entitled to a presumption of validity where the majority of a board of directors is independent,¹²⁸ the court felt that DCA's independent directors had not displayed "rea-

¹²¹See *Unilever Acquisition Corp. v. Richardson-Vicks, Inc.*, 618 F. Supp. 407 (S.D.N.Y. 1985); *Asarco, Inc. v. Court*, 611 F. Supp. 468 (D.N.J. 1985).

¹²²The *Wall Street Journal*, July 28, 1986, at 12, col. 1. The editorial commented favorably on Judge Posner's decision in *DCA V*. Of course, the editors somewhat smugly noted that the shareholders of Dow Jones & Company, which publishes the *Journal*, had approved a defensive scheme to protect management of that company. One might well wonder what the editorial stance would have been if someone had made a "play" for Dow Jones before any defensive moves could be adopted.

¹²³*DCA II*, 637 F. Supp. at 409.

¹²⁴*Id.*

¹²⁵493 A.2d 946 (Del. 1985).

¹²⁶500 A.2d 1346 (Del. 1985). *Moran* upheld a flip-over poison pill rights plan similar to the CTS flip-over plan. See also *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986).

¹²⁷*DCA II*, 637 F. Supp. at 411-18.

¹²⁸See *Moran*, 500 A.2d at 1356.

sonable grounds” for believing that DCA in fact presented a danger to CTS’s corporate policies. In fact, the court recognized a reasonable possibility that further evidence “might reveal some of the board’s stated concerns to be sham.”¹²⁹ Judge Getzendanner also noted that the testimony of CTS board members concerning the actual threat posed by DCA appeared to be in conflict.¹³⁰ This could indicate that their testimony was unreliable or that the CTS board simply had not discussed the matter thoroughly and that individual directors had different impressions of what was decided and resolved.¹³¹ Even a gross negligence standard would not guarantee success to CTS directors, although the court felt at this junction that gross negligence had not been established because CTS did not adopt the poison pill until it had obtained legal and investment advice.¹³²

CTS’s plan failed because, as is likely when defensive moves follow a hostile tender offer, the conclusion that the plan was “appropriate” apparently meant that it was appropriate to defeat the DCA offer or that any response that eliminated the DCA threat was “reasonable” once the board had decided the DCA offer represented a threat.¹³³ The court distinguished the Delaware cases¹³⁴ cited by CTS because they were tailored to protect the interests of minority shareholders without specific regard to entrenching management. CTS also was hurt by evidence indicating that the rights plan would hamper DCA’s proxy contest against incumbent management.¹³⁵ It would seem that as viewed by Judge Getzendanner, CTS was a little too “greedy” in adopting the rights plan which would deter not just repressive and hostile acquisitions, but all acquisitions, and thwart a bidding contest for CTS.

Judge Getzendanner made it clear that she was not invalidating all flip-in plans that inflict a penalty based on mere ownership, or even ownership levels as low as the fifteen percent triggering figure in the CTS plan. Rather, she was ruling that for purposes of a preliminary injunction, such a plan adopted in the heat of a proxy contest with no truly identifiable threat was unreasonable.¹³⁶

CTS, however, did not give up its battle against DCA following *DCA II*. It subsequently adopted a shareholder rights plan as part of

¹²⁹*DCA II*, 637 F. Supp. at 417.

¹³⁰*Id.*

¹³¹*Id.*

¹³²*Id.*

¹³³*Id.* at 417-18.

¹³⁴*Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986); *Moran v. Household Int’l, Inc.*, 500 A.2d 1346 (Del. 1985).

¹³⁵*DCA II*, 637 F. Supp. at 418.

¹³⁶*Id.* The court also concluded that DCA had established the other elements for injunctive relief. *Id.* at 418-19.

a white knight strategy for selling CTS. DCA challenged this strategy and the second rights plan as a breach of the directors' fiduciary duties in another action brought under section 14(a) of the Securities Exchange Act of 1934.¹³⁷ Judge Getzendanner denied the motion to enjoin the second rights plan in *DCA III*.¹³⁸

In ruling for CTS in this proceeding, Judge Getzendanner started from the premise that Indiana law treats a board of directors adopting defensive mechanisms in response to a takeover threat as having a conflict of interest.¹³⁹ This conflict mandates close judicial scrutiny of directors' actions. In other words, the directors must show they acted in good faith and made a reasonable investigation in determining that a danger to corporate policy existed and that the chosen defensive mechanism was reasonable in relation to the threat. If the directors satisfy this burden, they are protected by the business judgment rule, and a shareholder challenging their actions must show the primary purpose of the defense was entrenchment rather than protection of the shareholders' interest.

Following Judge Getzendanner's order in *DCA II*, the CTS board realigned its defensive measures to DCA's actual rather than perceived threat.¹⁴⁰ In essence, the second CTS rights plan put CTS up for sale, thus maximizing the value to shareholders other than DCA through an orderly auction of the company.

The new shareholder rights plan gave CTS shareholders a right to exchange CTS shares for one year notes with a principal amount of \$50.00 and a 10% interest rate. These notes became exercisable and traded separately from CTS common shares only if someone acquired a beneficial ownership of 28% or more of CTS common shares.¹⁴¹ The rights were to be postponed if the plan were triggered by a publicly announced tender offer for all outstanding CTS shares for \$50.00 or more.

The court in *DCA III* was faced with two issues: (1) were the press release and proxy statement announcing the proposed sale of CTS and the rights plan materially misleading; and (2) should the rights plan itself be enjoined.¹⁴²

DCA was unsuccessful in *DCA III* because the probability of suc-

¹³⁷15 U.S.C. § 78n(a) (1982).

¹³⁸*Dynamics Corp. of America v. CTS Corp.*, 635 F. Supp. 1174 (N.D. Ill. 1986).

¹³⁹*Id.* at 1176.

¹⁴⁰The CTS board formed a special committee of outside directors which explored the possibility of settling with DCA, but these settlement possibilities were not productive. *Id.* at 1176-77.

¹⁴¹*Id.* at 1177. This figure was slightly above the percentage of CTS which would be owned by DCA after its tender offer.

¹⁴²*Id.* The court in *DCA III* addressed only the second issue.

cessfully attacking the sale of CTS and the second rights plan as a breach of a fiduciary duty was decidedly lower than in *DCA II*. Also, the balance of hardships did not weigh sufficiently in DCA's favor to justify injunctive relief.¹⁴³

Judge Getzendanner again reiterated her conclusion in *DCA II* that although CTS management had not made a reasonable investigation of DCA's partial tender offer in adopting the flip-in rights plan, such conduct did not rise to the level of gross negligence.¹⁴⁴ DCA contended that the second rights plan was but a single-minded, continued effort at stopping DCA's proxy contest, while CTS argued that the plan was an honest attempt to correct the inadequacies of the first plan. Judge Getzendanner was persuaded by CTS's argument because the record now reflected a greater thoroughness of discussion and informed decision making prior to the adoption of the second rights plan.¹⁴⁵

DCA also argued that the decision to sell CTS was a breach of fiduciary duty because nothing had changed since CTS's unequivocal earlier view that it was an inopportune time to sell the company so as to warrant a different conclusion. In fact, DCA was hoist by its own petard in this respect because Judge Getzendanner was satisfied that DCA, which now owned just under the 28% trigger of the second rights plan, had changed the circumstances facing CTS, and that the directors had not changed their view as to the desirability of selling CTS but rather had concluded that a sale of CTS was "the lesser of two evils."¹⁴⁶ She also concluded that the "generalized" threat presented by DCA as a sizable minority shareholder to the sale of CTS to a third party was sufficient basis to keep the court from second guessing the advice given to CTS on the matter.¹⁴⁷

The court was satisfied that the CTS board had met the reasonable investigation standard of *Moran*,¹⁴⁸ although Judge Getzendanner did not accept CTS's argument in its entirety. She recognized that there were alternatives to the plan adopted by CTS and that the plan actually adopted was not the most reasonable response.¹⁴⁹ However, the burden on the directors was not to show that the plan was *the* most reasonable response but only that it was *a* reasonable response to the threat presented by DCA.

¹⁴³*Id.* at 1177-78.

¹⁴⁴*Id.* at 1178.

¹⁴⁵*Id.*

¹⁴⁶*Id.* DCA had not fully disclaimed the possibility that a future merger might be unfair to minority shareholders. Consequently the CTS board could conclude that a present sale of CTS would maximize shareholder values.

¹⁴⁷*Id.* at 1179.

¹⁴⁸*Moran v. Household Int'l, Inc.*, 500 A.2d 1346 (Del. 1985).

¹⁴⁹*DCA III*, 635 F. Supp. at 1180.

DCA's argument that the plan was unreasonable in giving management a potent weapon against unfriendly tender offers was rejected because, as supported by dicta in *Revlon*,¹⁵⁰ the plan could have started orderly bidding for CTS. Also, the plan could not deter all hostile offers because the rights expired on a tender for \$50 per share or more in cash. Whether DCA or anyone else thought that CTS was worth \$50 per share is another matter.

Under *Revlon*, a board of directors has a duty to insure that shareholders receive maximum value once it has decided to sell a company, even as the lesser evil. The *DCA III* court felt that DCA had raised some colorable arguments against the CTS decision to sell, but concluded that the probability of success was insufficient to justify an injunction.¹⁵¹

The court also rejected DCA's argument that the rights plan was adopted primarily for entrenchment purposes. Certainly the plan would aid management in the proxy contest insofar as a white knight strategy could garner votes from shareholders interested in cashing out of CTS. However, because a successful auction would, or could, result in a loss of control by the current CTS board, the plan could not be deemed a mere ploy to be re-elected.¹⁵² CTS had not adopted golden parachutes or other items that clearly promoted entrenchment, and even an unreasonable determination to stop DCA did not equal the goal of entrenchment. The second rights plan would not cause irreparable harm to DCA because it neither limited DCA to an equity position so low as to render successful proxy contests impossible, nor did it interfere with the ongoing tender offer as did the first rights plan.¹⁵³

DCA evened the score with CTS in *DCA IV*.¹⁵⁴ *DCA IV* related to an issue not considered in *DCA III*: DCA's motion for preliminary and permanent injunctive relief with respect to the CTS press release announcing the decision to sell CTS and the adoption of the second rights plan. DCA alleged the press release contained material misrepresentations and omissions in violation of the Securities Exchange Act of 1934.¹⁵⁵ CTS contended that a new proxy solicitation to shareholders and accompanying letter mooted the disclosure issues raised by DCA.¹⁵⁶

Clearly the new rights plan and the proposed sale of CTS were intended to affect the proxy contest and to attract potential white knights.

¹⁵⁰*Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1985).

¹⁵¹*DCA III*, 635 F. Supp. at 1180.

¹⁵²*Id.* at 1181.

¹⁵³*Id.* at 1182.

¹⁵⁴*Dynamics Corp. of America v. CTS Corp.*, Fed. Sec. L. Rep. (CCH) ¶ 92,765 (N.D. Ill. May 3, 1986).

¹⁵⁵15 U.S.C. § 78n(a) (1982).

¹⁵⁶*DCA IV*, Fed. Sec. L. Rep. at 93,747.

The key to the success of the CTS ploy was the price that CTS could attract. If management could sell at a high price, it would secure votes, but if the price were low, shareholders would probably prefer DCA.

The problem with the press release was obvious on its face: it "signaled" that CTS could be sold for \$50 a share, which was substantially higher than DCA's then existing tender offer price with no other buyers making a play for CTS. The court clearly was correct in considering the release and mandating corrective material. The letter accompanying the proxy statement did clarify the issue somewhat by noting that the \$50 value, which was the principal amount of the notes to be issued under the rights plan, was the asking price for the company and not a prediction.

There was some testimony that \$50 a share was a realizable price for CTS, but this figure was substantially discounted by Judge Getzendanner because it was based on management's untested expectations and seemed contrary to CTS's actual performance.¹⁵⁷ Consequently, even the supposed corrective statement in the letter accompanying the proxy statement was misleading because it did not disclose the basis of the opinion by CTS's investment banker or other information about the projections to permit shareholders to understand the limitations on the projected realizable value of CTS.¹⁵⁸ Also the letter indicating that CTS was for sale did not make clear management's view that it did not believe it was an opportune time to sell CTS and that the plan was based both upon management's fear that DCA would win the proxy contest unless a white knight strategy were adopted and upon a general but unspecified mistrust of DCA.¹⁵⁹

The final defect in CTS's disclosure related to its ability to issue the notes called for in the second rights plan if there were a triggering event. The court concluded that the letter failed to explain that to the extent CTS was unable to issue notes, shareholders would remain shareholders of a company that might have incurred substantial debt.¹⁶⁰ Judge Getzendanner felt that the disclosure could have been more specific and, more importantly, that management had not adequately disclosed what

¹⁵⁷*Id.* at 93,748.

¹⁵⁸*Id.* There was no disclosure that the investment advisor estimated the long-term value of CTS was \$75 per share realizable in two and a half years. This omission was deemed misleading because shareholders were in effect voting to sell CTS within twelve months at a maximum price of \$50 per share, and probably less, without being told that CTS had received an estimated value of \$75 per share if the company waited until 1988. Fed. Sec. L. Rep. at 93,749. This conclusion is somewhat ironic: management which did not want to sell erred by not disclosing information that would tend to dissuade shareholders from selling.

¹⁵⁹*Id.* at 93,749.

¹⁶⁰*Id.*

is perhaps the most important factor—management's belief that the rights plan would be so successful in deterring DCA or any other potential offeror from risking a triggering event that it was highly unlikely the \$50 notes ever would be issued. At the same time, management was signaling that a \$50 price could be realized within a year. It is irrelevant whether incumbent management or DCA could do the most for CTS shareholders, but it cannot be doubted that management had led the shareholders to, if not down, the "garden path" with a misleading proxy statement. Because of the substantial impact the press release had on the market for CTS shares, the only possible decision Judge Getzendanner could make was to enjoin CTS from voting proxies it had received subsequent to the issuance of the press release and to prevent contact with shareholders until corrective material had been sent.¹⁶¹

The most significant decision in the DCA-CTS battle to date is Judge Posner's opinion in *DCA V*¹⁶² affirming *DCA II* on the ground that the control share acquisition provisions of the Indiana Business Corporation Law¹⁶³ violate the supremacy and commerce clauses of the United State Constitution. Of course, even though Judge Posner's opinion can be characterized as a scholarly tour de force,¹⁶⁴ the decision by the Supreme Court either for or against the statute will be far more significant because of its impact on takeover law and tactics in general.

The first issue considered by the court was whether a preliminary injunction was appropriate. Judge Posner concluded that the irreparable harm to DCA if the injunction were denied and the irreparable harm to CTS if the injunction were granted basically offset each other. Thus the propriety of the injunction depended upon which side was likely to prevail at the trial.¹⁶⁵ The court concluded that this was DCA.

The first substantive issue considered by the court was whether the CTS poison pill violated management's fiduciary obligations to shareholders. This question was governed by Indiana law.¹⁶⁶ The function of

¹⁶¹*Id.* at 93,749-50.

¹⁶²*Dynamics Corp. of America v. CTS Corp.*, 794 F.2d 250 (7th Cir.), *prob. juris. noted*, 107 S. Ct. 258 (1986). The appeal to the Seventh Circuit was expedited. *Id.* at 252.

¹⁶³IND. CODE § 23-1-42-1 to -11 (Supp. 1986). CTS had "opted into" the IBCL after April 1, 1986, as permitted by *id.* § 23-1-17-3(b).

¹⁶⁴The opinion received favorable comment from the editors of *The Wall Street Journal*. *The Wall Street Journal*, July 28, 1986, at 12, col. 1.

¹⁶⁵*DCA V*, 794 F.2d at 252.

¹⁶⁶*Id.* at 253. The court stated that "Indiana takes its cues in matters of corporation law from the Delaware courts, which are more experienced in such matters since such a large fraction of major corporations is incorporated in Delaware and such a small fraction in Indiana." *Id.* This statement is not completely accurate. For example, in *Gabhart v. Gabhart*, 267 Ind. 370, 370 N.E.2d 345 (1977), the Indiana Supreme Court specifically declined to follow the Delaware decision in *Singer v. Magnavox Co.*, 380 A.2d 969 (Del.

the court was to predict how Indiana courts would evaluate the CTS poison pill in the context of the perennial debate over hostile takeovers: are they detrimental because they cause managers of potential targets to worry too much about short term financial results and promote absentee ownership or control, or are they unequivocally beneficial to shareholders because someone is offering a premium above the market price of the shares which is determined by all available public information about a company. Under the latter view, management as fiduciaries should embrace rather than oppose a takeover.¹⁶⁷

Judge Posner felt that Indiana courts would reject these polar views and would permit some defensive moves by target company management if they are not "insuperable barriers to hostile takeovers."¹⁶⁸ In fact, as the court pointed out, some defensive moves are required by federal law, such as the twenty day cooling off period between the announcement and the consummation of a tender offer.¹⁶⁹ Prohibiting short duration tender offers may discourage some offers because the offeror may have to compete with other offerors. The waiting period permits careful analysis of the offer and also permits other offerors to start an auction for the target. The court was even willing to recognize that "golden parachutes," where generous severance payments are triggered when managers lose their jobs because of a takeover, may benefit the shareholders if they reduce management's resistance to takeovers making a takeover more costly. Even a triggered "poison pill," if not lethal, could benefit shareholders. However, a poison pill could reduce the number of tender offers, or even the price, by making a tender offer less certain of success and more costly, thus harming all shareholders.¹⁷⁰

1977), on the issue of protecting minority shareholders in squeeze out mergers. 267 Ind. at 388, 370 N.E.2d at 356. Of course, with the demise of *Singer* in *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983), it can be said that the Indiana Supreme Court guessed right. However, *Gabhart* still shows that Indiana courts will not slavishly follow Delaware law.

¹⁶⁷*Compare, e.g.,* Scherer, *Takeovers: Present and Future Dangers*, BROOKINGS REV., Winter-Spring 1986, at 15 with, *e.g.,* Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981). Cf. SEC Office of Chief Economist, *A Study in the Economics of Poison Pills*, [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,971 (March 5, 1986).

¹⁶⁸*DCA V*, 794 F.2d at 253-54.

¹⁶⁹SEC Rule 14e-1(a), 17 C.F.R. § 240.14e-1(a) (1986).

¹⁷⁰*DCA V*, 794 F.2d at 254-55. Of course, the ideal solution for an offeror is to trigger a poison pill that bars anyone else from bidding for the target and then have the pill invalidated in court. This is what occurred in the recent takeover of N.L. Industries, Inc. See Zukosky, *N.L.'s Raider Gets His Prize—Minus a Few Marbles*, BUSINESS WEEK, August 25, 1986, at 37.

Considering Judge Posner's well known inclination for economic analysis, his reference to empirical studies on the results of tender offers is not surprising. In particular, he noted a finding that targets that resist offers but are later acquired do better in maximizing shareholder wealth, at least in the short run, than targets that do not resist.¹⁷¹ Of course if defensive tactics reduce the number of tender offers, shareholders may lose in the long run. Shareholders of a target that successfully resists an offer are unequivocally worse off.¹⁷² Thus, some resistance by management might be optimal and consistent with its duty of loyalty to the shareholders.¹⁷³ Of course striking the optimal level will be difficult because management with its vested self interests determines whether or not to resist an offer.

Judge Posner acknowledged skepticism about arguments for defensive measures because they give too little weight to the effect of "defensive" measures in rendering shareholders defenseless against management.¹⁷⁴ He was particularly skeptical about poison pills because they tend to be more a reflex device of a management determined to hold onto power at all costs than a considered measure for maximizing shareholder wealth. He contrasted poison pills with fair price amendments which require offerors to pay the same price to nontendering shareholders in subsequent mergers or cash outs. This device discourages shareholders from stampeding to tender their shares.

Although expressing doubts about poison pills, the court acknowledged that it was understandable why state courts would hesitate to condemn all defensive measures as breaches of fiduciary duties on the basis of the present incomplete evidence as to the actual effect of these measures.¹⁷⁵ Consequently Judge Posner assumed that Indiana would follow Delaware law and would recognize defensive measures, including poison pills, as within the power of the target's board of directors.¹⁷⁶ However, there must be some nexus with the goal of maximizing return to the shareholder, and the directors must show that they had reasonable grounds for believing that the offeror presented a threat to corporate

¹⁷¹See Jarrell, *The Wealth Effects of Litigation by Targets: Do Interests Diverge in a Merge?*, 28 J. LAW & ECON. 151 (1985).

¹⁷²*DCA V*, 794 F.2d at 255.

¹⁷³*Id.*

¹⁷⁴*Id.*

¹⁷⁵*Id.* at 255-56. Of course, it is possible that state courts would be less inclined to rely on economic analysis than Judge Posner, who always has advocated such an analysis both as a scholar and as a jurist.

¹⁷⁶See, e.g., *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 180 (Del. 1986).

policy and effectiveness in adopting defensive measures. Admittedly, this burden is easily satisfied by a showing of good faith and reasonable investigation.¹⁷⁷ CTS had argued that the "business judgment rule" insulated its decision to adopt the poison pill from judicial scrutiny. Although the Delaware court has done some backing and filling with respect to the boundaries of the business judgment rule, there is no question that it has departed from the preternatural deference it once gave to directors reacting to any perceived threat to their continued control of a corporation.¹⁷⁸

Judge Posner, not surprisingly, justified the business judgment rule in "market" terms, recognizing the penalty that competition in the market for corporate control can impose on a management that makes business mistakes, as well as recognizing the traditional justification that people running a business know more about the business than do judges.¹⁷⁹ However, when management interferes with the market for corporate control, the courts are less deferential because of the conflict between the interests of a management seeking to secure its position and shareholders seeking to maximize their wealth.¹⁸⁰

After making these "general reflections" on the role of the courts in reviewing defensive maneuvers, Judge Posner analyzed the CTS poison pill. Not surprisingly, he felt that CTS's act was not done in a disinterested fashion and that the board had not evaluated in a cool, dispassionate, and thorough manner DCA's tender offer for shares intended as part of its proxy contest strategy. CTS's failure, in the court's eyes, was the decision by CTS inside directors to block the DCA tender offer before considering its ramifications for shareholder welfare.¹⁸¹ For example, the presentation of the poison pill plan by CTS's investment advisor implied that the DCA tender offer was "unfair," although the board had not even considered the fairness of the DCA offer price. Apparently the "market" did analyze the DCA offer because the price of CTS shares rose from below \$36 to above \$40 when the offer was announced, only to drop when the poison pill was announced and rise again when Judge Getzendanner invalidated the poison pill.¹⁸² Of course it is doubtful that any poison pill adopted during the heat of battle, rather than beforehand, could ever be characterized as a dispassionate act.

CTS made a rather *ad hominem* argument that it did not need to

¹⁷⁷*Id.*; see also *Moran v. Household Int'l, Inc.*, 500 A.2d 1346 (Del. 1985); *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

¹⁷⁸See, e.g., *Cheff v. Mathes*, 41 Del. Ch. 494, 199 A.2d 548 (1964).

¹⁷⁹*DCA V*, 794 F.2d at 256.

¹⁸⁰*Id.*

¹⁸¹*Id.* at 257. Judge Posner drolly quoted from the Queen of Hearts in *ALICE IN WONDERLAND*: "Judgment first, trial later." *Id.*

¹⁸²*Id.*

investigate the DCA offer to know that it was bad because of the antagonism between DCA and CTS management. Apparently CTS management thought it was focusing on the long term while DCA was going for the quick buck. However, this attitude could be discounted considering the souring of some CTS investments that had been opposed by DCA. Furthermore, in a comment that should be noted by all those in the position of CTS management, Judge Posner stated that “[t]he friction between the companies required, if anything, more than the usual amount of care by CTS’s board of directors in evaluating the proposal, to make sure that personal feelings would not be allowed to interfere with the board’s fiduciary obligations.”¹⁸³

Judge Posner was not particularly impressed with the poison pill as a plausible measure for maximizing shareholder wealth. He conceded that it was not certain that CTS shareholders, other than DCA, would be worse off if the pill were triggered. It was, however, at least overkill and too high a price to pay for preventing a shift in control from incumbent CTS management to DCA. Even if the tender offer succeeded, DCA could not squeeze out remaining shareholders because it would not own a majority of shares. A reasonable defensive move would be a device that would be triggered by a transaction that created a majority shareholder or by an attempt to squeeze out minority shareholders in an unfair transaction.¹⁸⁴

Judge Posner turned one CTS argument against itself. CTS apparently argued that if DCA controlled the board of directors, it would “gull” the remaining shareholders into selling their shares for too low a price.¹⁸⁵ As Judge Posner again drolly observed, this argument underscores the importance of not impeding tender offers too much because its premise is that management cannot be trusted to protect the interests of shareholders.¹⁸⁶ *Touche*.

After disposing of the validity of CTS’s poison pill, the court considered the validity of the control share acquisition provisions of the IBCL. The first issue was the procedural question whether the trial court had failed adequately to notify the Indiana Attorney General that the constitutionality of the statute was being challenged.¹⁸⁷ The court was

¹⁸³*Id.* at 258.

¹⁸⁴*Id.* at 259.

¹⁸⁵*Id.* It is ironic that recently DCA opposed a sale of CTS, or more accurately, opposed a merger of CTS with AVX Corporation. Indianapolis Star, Dec. 18, 1986, at 73, col. 2. Of course the merger price was \$35 per share, \$8 less than what DCA offered in its tender offer. Then again, this development proves the court was right—the \$50 was illusory, and one of the features of the AVX proposal was that AVX considered “CTS management . . . [as] one of the positive things about the company.” *Id.*

¹⁸⁶*DCA V*, 794 F.2d at 259.

¹⁸⁷*Id.* Although a detailed discussion of notification would unduly lengthen this article, the federal statute that requires notification is 28 U.S.C. § 2403(b) (1982).

satisfied that any error in notification did not prejudice the state.¹⁸⁸ It is possible that the United States Supreme Court might reverse the Seventh Circuit on the ground that Indiana has not had its day in court.¹⁸⁹ Hopefully, however, the high court will reach the merits of the constitutionality of second generation antitakeover statutes such as the Indiana statute regardless of the outcome of preliminary issues.

The first constitutional issue considered in *DCA V* was the supremacy clause issue: was the control share acquisition statute¹⁹⁰ preempted by the Williams Act.¹⁹¹ The Indiana statute defines a control share acquisition as an acquisition that with any previous acquisitions gives the acquiror at least twenty percent of the voting shares of the covered firm.¹⁹² If the acquiring firm files a statement containing specific information¹⁹³ and requests a special shareholders' meeting to consider whether the shares should have voting rights, management has fifty days within which to hold a shareholders' meeting.¹⁹⁴ The statute requires that a majority of all shares and a majority of disinterested shares, which excludes shares owned by the acquiror and shares owned by officers and inside directors, must favor awarding voting rights.¹⁹⁵

Judge Posner characterized the statute as being "cleverly drafted . . . to skirt judicial holdings that forbid states to delay tender offers beyond the period required by the Williams Act."¹⁹⁶ Of course the effect of the statute is to impose a fifty day delay on tender offers at the option of the target. This makes it more difficult for any tender offer to succeed, because an offeror could not accept tendered shares until the shareholder meeting where it will be determined if the shares will

¹⁸⁸*DCA V*, 794 F.2d at 260.

¹⁸⁹*Cf.* *Leroy v. Great Western United Corp.*, 443 U.S. 173 (1979). The court also dismissed two other threshold challenges to Judge Getzendanner's constitutional rulings. The Attorney General's argument that venue was improper in the Northern District of Illinois was deemed to have been waived by CTS. An argument that the district court should have abstained in favor of Indiana courts was rejected in part because of the lack of time, but more particularly because the court agreed that the statute was limited to cases where the target was an Indiana corporation. *DCA V*, 794 F.2d at 260.

¹⁹⁰IND. CODE § 23-1-42-1 to -11 (Supp. 1986).

¹⁹¹15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1982).

¹⁹²IND. CODE § 23-1-42-1 (Supp. 1986).

¹⁹³*Id.* § 23-1-42-6.

¹⁹⁴*Id.* § 23-1-42-7.

¹⁹⁵*Id.* §§ 23-1-42-3, 23-1-42-9. Without a majority vote of all shares, and of all disinterested shares, the acquired shares remain non-voting shares. The issue of the voting rights will be taken up at the next regularly scheduled shareholder meeting if the acquirer does not request a special meeting. *Id.* § 23-1-42-7(c). If the statement is not filed, the corporation can redeem the shares "at the fair value thereof pursuant to the procedures adopted by the corporation." *Id.* § 23-1-42-10. One might conjecture how close the "fair value" would be to what the acquirer had paid for the shares.

¹⁹⁶*DCA V*, 794 F.2d at 261.

be voting or nonvoting. Thus a tender offer would have to be kept open for fifty days rather than the twenty business days required by SEC Rule 14e-1(a),¹⁹⁷ and even then the offeror cannot be certain of a victory because the "disinterested" shareholders must approve the vote.¹⁹⁸

The key to any analysis of a supremacy clause preemption issue is *Edgar v. MITE Corp.*¹⁹⁹ The Seventh Circuit in *MITE* held that the Illinois takeover statute violated the supremacy clause, but this view was shared by only three Supreme Court justices.²⁰⁰ However, even though the Supreme Court did not accept the preemption argument, it has held that Congress intended to strike a balance between target management and offerors in the Williams Act.²⁰¹ From this premise, courts have reasoned that states may not upset the balance struck by Congress.²⁰² States are free to add their own penalties if Congress passes a statute punishing some practice deemed unfair or unjust such as monopolization or misrepresentation.²⁰³ If the Williams Act is actually an antitakeover statute, as some argue,²⁰⁴ then Indiana should be able to enact more stringent antitakeover laws. However, even if Judge Posner might philosophically agree with those who oppose any interference in the market for control, the Williams Act does exist and it does strike a balance.²⁰⁵ Whether or not the balance is proper, Congress probably did not want the states to tip this so-called "balanced playing field" one way or the other.

Judge Posner characterized the application of the standard preemptive power of the Williams Act to the Indiana statute as "straight forward."²⁰⁶ He did not attempt to determine if the Indiana statute was more or less hostile to takeovers than the Illinois statute involved in *MITE*. In fact, he "guessed" that the Indiana statute was less inimical to tender offers, although it was still lethal. In particular, Judge Posner considered the fifty day period of the Indiana statute to be "too much" when

¹⁹⁷SEC Rule 14e-1(a); 17 C.F.R. § 240.14e-1(a) (1986).

¹⁹⁸Officers and inside directors are disenfranchised as well, but their holdings are likely to be substantially less than the holdings of the offeror. Offerors are not prone to put a corporation into play if it has a strongly entrenched management.

¹⁹⁹457 U.S. 624 (1982), *aff'g* *MITE Corp. v. Dixon*, 633 F.2d 486 (7th Cir. 1980).

²⁰⁰457 U.S. at 636-39. This portion of the opinion by White, J., was joined by Burger, C. J., and Blackmun, J.

²⁰¹*Piper v. Chris-Craft Indus., Inc.*, 430 U.S. 1 (1977).

²⁰²*See, e.g., Martin-Marietta Corp. v. Bendix Corp.*, 690 F.2d 558, 565-66 (6th Cir. 1982); *National City Lines, Inc. v. LLC Corp.*, 687 F.2d 1122, 1128-33 (8th Cir. 1982).

²⁰³*DCA V*, 794 F.2d at 262.

²⁰⁴*See, e.g., Fischel, Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers*, 57 *TEX. L. REV.* 1 (1978).

²⁰⁵*DCA V*, 794 F.2d at 262.

²⁰⁶*Id.*

Congress had determined that approximately a month is enough time to keep a tender offer open.²⁰⁷

It is possible that the preemption issue raised by Judge Posner could be resolved by shortening the time frame of the control share acquisition statute. However, even if this occurs, Judge Posner made it clear that in the opinion of the panel, the statute would still run afoul of the commerce clause.²⁰⁸ It has been a long established tenet of constitutional law that the commerce clause will invalidate any state regulation of interstate commerce that conflicts with the presumed purpose of the clause to make the nation a common market, at least in areas where Congress has not spoken.²⁰⁹ Judge Posner recognized, however, that it was possible that the "dormant" commerce clause would no longer apply when Congress has spoken and that the only ground for invalidating state legislation would be the supremacy clause.²¹⁰

However, as the *DCA V* court pointed out, *MITE* and other cases separate the supremacy and the commerce clauses and assume that the commerce clause retains an independent force notwithstanding the enactment of the Williams Act.²¹¹ Judge Posner, in this respect, stated that there was no indication the Williams Act was intended to insulate antitakeover statutes from complaints that they unduly burden interstate commerce.²¹²

The commerce clause does not bar all state action that might impose some burden on interstate commerce; burdens will be upheld if the local benefits exceed the burden imposed upon interstate commerce.²¹³ Applying this test, the court concluded that the burdens the statute inflicted on nonresidents exceeded the benefits to Indiana residents.²¹⁴ Although the court did not know the geographical distribution of the *DCA* or *CTS* shareholders, Judge Posner was willing to assume that the vast majority were not Indiana residents. Consequently the statute gravely impaired *DCA*'s ability to do business with those shareholders. As he phrased it, "Indiana has no interest in protecting residents of Connecticut from being stampeded to tender their shares to Dynamics at \$43,"²¹⁵ and

²⁰⁷*Id.* at 263.

²⁰⁸*Id.*

²⁰⁹*Id.* See *Cooley v. Board of Wardens*, 53 U.S. (12 How.) 299 (1852).

²¹⁰*DCA V*, 794 F.2d at 263.

²¹¹*Id.*

²¹²*Id.*

²¹³See *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970). A majority of the Supreme Court in *MITE* found that the Illinois statute violated the commerce clause as an undue, indirect burden on interstate commerce. *Edgar v. MITE Corp.*, 457 U.S. 624, 640-46 (1982).

²¹⁴*DCA V*, 794 F.2d at 264.

²¹⁵*Id.* at 263.

“[f]or the sake of trivial or even negative benefits to its residents Indiana is depriving nonresidents of the valued opportunity to accept tender offers from other nonresidents.”²¹⁶ This cannot be gainsaid because the *purpose* of the control share acquisition statute like that of any other state antitakeover statute is to impede transactions between residents of other states. This, of course, is the opposite of the purpose of state securities laws, which affect only the residents of the particular state.

Judge Posner even expressed some doubts if any appreciable number of Indiana shareholders would benefit from the statute; the only beneficiaries might be the officers and directors of CTS, not all of whom necessarily were Indiana residents.²¹⁷ He noted that no evidence had been presented that DCA's takeover of CTS would reduce the value of CTS or result in a shift of assets or employment from Indiana.²¹⁸ More importantly, and this point could well be fatal to all second generation antitakeover statutes, any shift prevented by the statute would be further grounds for condemnation because the commerce clause does not permit states to bar corporations from moving assets and employees to other states.²¹⁹ If Indiana presents a desirable environment for business,²²⁰ there is no reason for erecting obstacles to shifts in corporate control. If the environment is desirable, the business will remain in Indiana regardless of whether management are “hometown boys” or nonresidents. For better or worse, there is an interstate and even an international market for corporate control. Indiana has attempted to opt out of this market, and to the *DCA V* court, this effort is barred by the commerce clause.

Perhaps anticipating that this case would go to the Supreme Court, Judge Posner was careful to distinguish the cases relied on by CTS. For example, *L.P. Acquisition Co. v. Tyson*²²¹ was different because the Williams Act did not apply to the tender offer, and the disclosures required by the particular statute conferred greater benefits on state residents than the disclosure required by the Indiana statute.²²² In other words, the court perceived *Tyson* as satisfying the balance required by *Pike v. Bruce Church, Inc.*,²²³ which permits an indirect “burden” on

²¹⁶*Id.* at 264.

²¹⁷*Id.*

²¹⁸*Id.*

²¹⁹*Id.*

²²⁰A recent study commended Indiana's approach to attracting new businesses to the state. *Indianapolis Star*, Oct. 1, 1986, at 22, col. 2. It would be interesting to know how many business executives who favor legislation such as the control shares acquisition statute would favor legislation barring them from relocating or building new plants and facilities in other states. Close to home, how many Indiana residents would have approved of legislation that would have kept the Colts in Baltimore?

²²¹772 F.2d 201 (6th Cir. 1985).

²²²*DCA V*, 794 F.2d at 264.

²²³397 U.S. 137 (1970).

interstate commerce where local interests are paramount. The court also distinguished *Cardiff Acquisitions, Inc. v. Hatch*²²⁴ on the grounds that the required disclosure was designed to furnish state residents information relevant to the takeover's impact on the state and that any delay imposed on takeovers was so slight as not to discourage them.²²⁵ The Indiana statute, however, was perceived by the court as erecting a "barrier at once formidable and arbitrary to tender offers whose principal effects if they succeed will be felt outside Indiana."²²⁶

The court also rejected CTS's argument that Indiana should be permitted to control and regulate the internal affairs of Indiana corporations. The court correctly recognized that Indiana has a broad latitude in regulating internal affairs of Indiana corporations, including provisions in corporate documents that would discourage takeovers.²²⁷ However, there are limits to this doctrine, which are exceeded when the state regulation has an effect "on the interstate market in securities and corporate control [that] is direct, intended and substantial . . . [and] not merely the incidental effect of a general regulation of internal corporate governance."²²⁸ As Judge Posner accurately if not elegantly phrased it, the control share acquisition statute is an explicit regulation of tender offers and is not immunized from the commerce clause because "the mode of regulation involves jiggering with voting rights. . . ."²²⁹

²²⁴751 F.2d 906 (8th Cir. 1984).

²²⁵*DCA V*, 794 F.2d at 264.

²²⁶*Id.*

²²⁷The court referred to cumulative voting, which can make it difficult to oust an entire existing board of directors. A staggered board of directors also would be a permitted defensive move. *Id.*

It is possible that the Supreme Court may place more emphasis on the "internal affairs" doctrine or at least distinguish *DCA V* from *Edgar v. MITE Corp.* because in *Edgar*, it was possible for the Illinois statute to apply to a tender offer "which would not affect a single Illinois shareholder," 465 U.S. at 465, whereas the Indiana control share acquisition provisions apply only to publicly owned corporations with a substantial number of Indiana shareholders or with a substantial number of shares owned by Indiana residents. IND. CODE § 23-1-42-4(a)(3) (Supp. 1986). This position or a complete reconsideration of the *MITE* position on the "internal affairs" doctrine in effect would totally insulate state antitakeover statutes from commerce clause scrutiny as long as they are limited to domestic corporations with a "substantial" number of resident shareholders even if they are a minority of all shareholders.

It might be argued that rejection of the "internal affairs" doctrine would invalidate any statutory provision that might hinder a hostile takeover. That, however, is basically an *in terrorem* argument because a statutory provision that applies to all corporations regardless of whether they are the target of a hostile takeover attempt is not the same as a provision that applies only to publicly held target companies and that has as a purpose hindering the market for corporate control.

²²⁸*DCA V*, 794 F.2d at 264.

²²⁹*Id.* The court also rejected the argument that the tender offer should have been enjoined because if successful, *DCA* and CTS would violate section 8 of the Clayton Act, 15 U.S.C. § 19 (1982), which prohibits interlocking boards of directors that might eliminate

The court also declined to reverse on the ground that DCA's tender offer materials did not disclose its intention to oust the CTS management if it succeeded in the proxy contest. Judge Posner agreed that this omission, although material, had been cured because DCA's proxy material urged shareholders to elect the DCA slate of directors and because DCA's desire to oust the present CTS board was broadcast loudly and widely.²³⁰ Even if the defect could not be cured by the proxy materials, an issue not resolved by the court, it was not clear that enjoining the tender offer was a proper remedy. The proper remedy was within the district court's discretion, which had not been abused in this case.²³¹

It is of course impossible to know if the Supreme Court will uphold the Seventh Circuit's decision in *DCA V.*²³² There is no question that the statute was intended to and does interfere with takeovers. Judge Posner's treatment of the commerce clause issue, which was accepted by the majority in *MITE*, should be persuasive. Any statute that presents an offeror with the distinct possibility of owning a substantial block of non-voting shares in an Indiana corporation would tend to dissuade him from making a tender offer for that corporation. The adverse effect on interstate commerce is clear.

It would be unfortunate if tender offers and takeovers reduced the number of publicly held Indiana corporations. However, the answer to this potential problem is to improve the business climate in Indiana to attract and retain business in this state rather than to create artificial barriers to a shift in corporate control.

Judge Posner's supremacy clause argument also is persuasive because for better or worse, the Williams Act does establish a uniform scheme for the regulation of tender offers. Tender offers and takeovers have national impact and it would seem that even in a time of deemphasis on Washington, having one set of rules for the country is sound. If there is a problem with particular tactics by offerors, or management for that matter, the proper response is to seek change from Congress or the SEC.

An Ohio control share acquisition statute which was similar to the Indiana statute in that it required shareholder authorization for a control

competition between the two companies. Judge Posner, an eminent antitrust scholar, noted there was no persuasive evidence that DCA and CTS were in competition, but more importantly the argument failed for the very simple reason that DCA would just find persons to serve on the board of CTS who were not DCA directors if there was a question of illegality under section 8. *DCA V.*, 794 F.2d at 264-65.

²³⁰*DCA V.*, 794 F.2d at 265.

²³¹*Id.*

²³²It is difficult to forecast how the current Court will line up on the issue. Former Chief Justice Burger was in the plurality that deemed the Illinois statute involved in *MITE* preempted by the Williams Act, 457 U.S. at 636-39, while current Chief Justice Rehnquist dissented in *MITE* on the grounds of mootness. *Id.* at 664.

share acquisition was struck down in *Fleet Aerospace Corp. v. Holderman*²³³ because it conflicted with the supremacy clause by frustrating the objectives of the Williams Act and because it imposed a substantial direct and indirect burden on interstate commerce.²³⁴

It is hard to predict the reaction of the state if *DCA V* is affirmed. Presumably efforts would be made to circumvent the decision, perhaps by a statute that applies only to corporations not subject to the Williams Act, where the predominant number of shareholders are Indiana residents and that are truly local businesses. This type of statute would apply to just the kind of small corporations that always seem to be excluded from antitakeover legislation.

IV. STATUTORY DEVELOPMENTS

A. *Indiana Business Corporation Law*

The most significant statutory development during the survey period was the enactment of the Indiana Business Corporation Law.²³⁵ By its terms, the IBCL applies to all existing Indiana corporations as of August 1, 1987.²³⁶ It makes sense to have a single system of corporation law rather than two different and overlapping systems, and normally this approach would not cause any problems. Unfortunately this stratagem might not be available in Indiana, at least for corporations organized between July 1, 1978, and February 21, 1986, if the provisions of the IBCL are not expressly and unanimously adopted by the shareholders.

This hiatus is the time in which there was no "reserved powers" clause in the IGCA reserving to the General Assembly the right to amend or repeal the law relating to corporations. July 1, 1978, was the effective date of repeal of the clause that had been in the IGCA.²³⁷ It is distinctly

²³³796 F.2d 135 (6th Cir. 1986).

²³⁴The *Fleet* court relied on *DCA V* in deciding against the Ohio statute. *Id.* at 139.

²³⁵Act of March 26, 1986, Pub. L. No. 149-1986, §§ 1-69 (codified at IND. CODE §§ 23-1-17-1 to -54-2 (Supp. 1986)). See Simcox, *The Indiana Business Corporation Law: Tool for Flexibility, Simplicity and Uniformity*, 20 IND. L. REV. 119 (1987).

²³⁶IND. CODE § 23-1-17-3(a) (Supp. 1986).

²³⁷IND. CODE § 23-1-12-5 (1972) (repealed 1978). There was no reserved powers clause in the IGCA when it was adopted in 1929. It was added in 1949. Frederick Schortemeier, who chaired the Indiana Corporations Survey Commission when the IGCA was adopted later commented that it was felt the state had "inherent power" to amend the IGCA but that it was advisable to make the power express. F. SCHORTEMEIER, *INDIANA CORPORATION LAW* 206 n.11 (1952).

There is dictum in *City of Indianapolis v. Navin*, 151 Ind. 139, 143, 47 N.E. 525, 526-27 (1897), that the legislature has inherent power to regulate the fares of a common carrier as specified in the organic documents of the corporation. This might be the source of Mr. Schortemeier's comment. However, the statement was dictum because the General Assembly had reserved the power to regulate fares. Furthermore, the court recognized

possible that a court can rule that in 1978, the General Assembly surrendered Indiana's authority to affect subsequently organized corporations by altering, amending, or even repealing the IGCA. Of course, it is also possible a court could rule that the repeal was a careless, unintended act. The drafters of the Revised Model Business Corporation Act took the position that the RMBCA should apply to existing as well as new corporations.²³⁸ They also intended the act to supplant existing general incorporation statutes and recommended against retaining portions of earlier statutes.²³⁹ The Corporation Law Study Commission, which drafted the IBCL, had the same intent. Unfortunately, the drafters of the RMBCA also operated on the premise that there had been a "universal adoption of 'reservation of power' clauses in all states for more than a century"²⁴⁰ This was not the case in Indiana.

The General Assembly remedied or at least attempted to remedy this problem in 1986. On February 21, 1986, Indiana Code section 23-1-12-5.1(a) was added to the IGCA, retroactively reserving the right to "alter, amend or repeal" the IGCA.²⁴¹ This corrective legislation also contained section 23-1-12-5.1(b), which stated that

the purpose of the General Assembly in enacting this section is to correct an error that was made in preparation of Acts 1978, P.L. 2, SECTION 2325. The general assembly finds and declares that the inclusion of IC 23-1-12-5 in the list of provisions to be repealed by Acts 1978, P.L. 2 was a clerical error, and that the general assembly did not intend to repeal IC 23-1-12-5 when it enacted Acts 1978, P.L. 2.²⁴²

that it would take "clear and unmistakable language" inconsistent with the exercise of the power over fares to surrender such power. *Id.* There is no clearer or more unmistakable statement of legislative intent to surrender the reserved power than expressly repealing the clause unless, of course, a mistake has been made.

The decision in *State ex rel. Starkey 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 provisions in the Model Business Corporation Act which had been adopted in Alaska could not be applied to a corporation organized under the previous territorial corporation act which had not contained a reserved powers clause. *Id.*

²³⁸4 MODEL BUS. CORP. ACT ANN. § 17.01 (3d ed. 1985).

²³⁹*Id.* § 17.05 (Official Comment at 1800). The practice was discouraged because it could cause unnecessary confusion in determining applicable law and create possible internal statutory conflicts. *Id.*

²⁴⁰*Id.* § 17.01 (Official Comment at 1797).

²⁴¹Act of February 21, 1986, Pub. L. No. 19-1986, § 39(a) (codified at IND. CODE § 23-1-12-5.1(a) (Supp. 1986)). The effective date of IND. CODE § 23-1-12-5.1(a) was July 1, 1978.

²⁴²Act of February 21, 1986, Pub. L. No. 19-1986, § 39(b) (codified at IND. CODE § 23-1-12-5.1(b) (Supp. 1986)).

This author will not quarrel with the General Assembly's statement that including Indiana Code section 23-1-12-5 in the list of provisions to be repealed was a "clerical

The General Assembly also added a reserved powers clause applicable to all general laws to the Indiana Code.²⁴³ Thus the issue of reserved powers was clearly resolved for corporations organized under the IGCA between February 21, 1986, and the August 1, 1987, effective date of the IBCL. The IBCL, of course, contains a reserved powers clause.²⁴⁴

The problem is that it is not clear that the General Assembly can retroactively enact a reserved powers clause, or at least the extent to which it can. It has long been recognized in Indiana that the General Assembly cannot amend or otherwise materially modify the charter of a special charter corporation unless the power was expressly reserved.²⁴⁵ It also has been recognized by Indiana courts that a statute cannot be applied retroactively if such application impairs vested rights.²⁴⁶ Even cases such as *Wencke v. City of Indianapolis*,²⁴⁷ which posit that the "power to enact statutes and ordinances has as a necessary incident the power to repeal[.]" qualify that power by subjecting it to "constitutional restrictions such as the prohibition against impairment of contract."²⁴⁸

It is very likely that the IBCL might have an impact on the interests of shareholders of corporations organized during the hiatus. There is some question whether the IBCL overruled the Indiana Supreme Court decision in *Gabhart v. Gabhart*.²⁴⁹ *Gabhart* protects the interest of mi-

error." However Indiana Code section 23-1-12-6, which was a "savings clause," also was repealed at the same time. This would seem to indicate something more than a mere error by a scrivener. The wisdom of repealing a savings clause is not readily apparent, but at least corporations organized under pre-IGCA law had limited duration unless reorganized under the IGCA and in 1978 had at most one year of corporate existence left. There was no effort to reinstate Indiana Code section 23-1-12-6 in 1986.

²⁴³IND. CODE § 1-1-5-2 (Supp. 1986). This provision reads:

Each general law of the state is enacted subject to the right of the general assembly to amend or repeal that law at any time, unless the general assembly waives this right in that law. Except in the case of a law containing a covenant that the general assembly will not amend or repeal that law, the general assembly may not be construed to have waived its right to amend or repeal any general law at any time.

Id. It will be interesting to see if a law containing a "covenant" that it will not be amended or repealed in fact will be safe from amendment or repeal without more. The courts have held on several occasions that the General Assembly cannot limit the rights of future General Assemblies. See *State ex rel. City of Terre Haute v. Kolsem*, 130 Ind. 434, 29 N.E. 595 (1891); *Wencke v. City of Indianapolis*, 429 N.E.2d 295 (Ind. Ct. App. 1981); *Martin v. Simplimatic Eng'g Corp.*, 181 Ind. App. 10, 390 N.E.2d 235 (1979).

²⁴⁴IND. CODE § 23-1-17-2 (Supp. 1986).

²⁴⁵See *City of Terre Haute v. Evansville & T.H.R.R.*, 149 Ind. 174, 180, 46 N.E. 77, 78 (1897).

²⁴⁶*Hinds v. McNair*, 413 N.E.2d 586, 608-09 n.20 (Ind. Ct. App. 1980).

²⁴⁷429 N.E.2d 295 (Ind. Ct. App. 1981).

²⁴⁸*Id.* at 297. See *Trustees of Dartmouth College v. Woodward*, 17 U.S. (4 Wheat.) 518 (1819).

²⁴⁹267 Ind. 370, 370 N.E.2d 345 (1977).

minority shareholders subject to a squeeze out by means of a reverse share split. If the IBCL does overrule *Gabhart*, a minority shareholder might have a cause of action for overreaching conduct by controlling shareholders occurring before July 31, 1987, which conduct is clearly proper under the IBCL if it occurs on or after August 1, 1987. Thus, a right provided by Indiana corporation law when the corporation was organized has been taken away by the IBCL. It certainly can be argued that shareholders of corporations organized when there was no reserved powers clause are entitled to the protections accorded to minority shareholders under the law existing as of the date of incorporation. This would be the law reflected in *Gabhart*.

A not implausible example would be overreaching conduct directed against one minority shareholder on July 31, 1987, and exactly the same conduct directed against another shareholder on August 1, 1987. The first shareholder has a cause of action which would be preserved under the savings clause of the IBCL,²⁵⁰ but the second shareholder will have no remedy because of a change in the organic law that was part of the "contract" the shareholder had with other shareholders and the state. This contract created certain rights; the state cannot take away those rights without having reserved the power to do so at the time the corporation was organized. At least this is how the argument for the second minority shareholder would be framed. It is far from certain that this argument will prevail. However, any lawyer worthy of the title "professional" would argue that when section 23-1-12-5 was repealed, the "contract" between the state and a corporation and its shareholders specifically excluded the right of the state to change the terms of the contract, and that the corporation and the shareholders have a vested interest in not having Indiana retroactively impose the "right" to alter, amend, or repeal.

It is possible for shareholders to waive their rights, and nothing would prohibit shareholders from unanimously subjecting themselves and the corporation to the IBCL. Such an act would bind subsequent shareholders because that will be part of the contract that goes with their shares. However, unless and until that is done, there is at least the intriguing possibility that the General Assembly's attempt to establish retroactively a reserved powers clause was unsuccessful.

It does not make any difference that the General Assembly adopted a new but retroactive reserved powers clause rather than repealing its repeal of section 23-1-12-5. The Indiana Code does provide that the repeal of an act repealing a former act can, if expressly provided, revive

²⁵⁰The savings clause is not part of the IBCL as it is with the RMBCA, 4 MODEL BUS. CORP. ACT ANN. § 17.03 (3d ed. 1985), but was provided for separately in Act of March 26, 1986, Pub. L. No. 149-1986, § 66(a)(b).

the former act.²⁵¹ Generally, when a statute is repealed, it is completely obliterated unless a vested right is impaired.²⁵² If there were a vested right in the absence of a reserved powers clause, it would survive the repeal.

It will be interesting to see if someone challenges the application of the IBCL to corporations organized between July 1, 1978, and February 21, 1986, and if so, whether such an attack is successful.

The General Assembly continued the Corporation Law Study Commission²⁵³ to permit it to publish Official Comments on the new IBCL. The IBCL specifically authorizes courts to consider these Official Comments in construing the act, so they might be characterized as after the fact legislative history.²⁵⁴

B. Business Combinations

The General Assembly also added a new chapter to the Indiana General Corporation Act relating to business combinations.²⁵⁵ This chapter is substantially the same as chapter 43 of the new IBCL²⁵⁶ and will be superceded when the IBCL becomes effective.

C. Liability of Directors of Not-for-Profit Corporations

In 1985, the General Assembly enacted a statute limiting the civil liability of voluntary directors of not-for-profit corporations that have certain specified purposes.²⁵⁷ The statute limits civil liability for the negligent performance of duties by individuals who serve without compensation as directors for the purpose of setting policy, controlling, or otherwise overseeing the activities or functional responsibilities of such corporations.²⁵⁸ The liability is limited to the coverage provided by an insurance policy issued to the particular entity.²⁵⁹

As enacted, the provision presented the possible anomalous result of a director of a not-for-profit corporation having limited liability if there was an insurance policy but unlimited liability if there was not.

²⁵¹IND. CODE § 1-1-5-1 (1982).

²⁵²*Martin v. Simplimatic Eng'g, Inc.*, 181 Ind. App. 10, 11, 390 N.E.2d 235, 236 (1979).

²⁵³IND. CODE § 23-1-17-5 (Supp. 1986).

²⁵⁴*Id.*

²⁵⁵Law of January 23, 1986, Pub. L. No. 151-1986, § 1 (codified at IND. CODE §§ 23-3-9-1 to -22 (Supp. 1986)).

²⁵⁶IND. CODE §§ 23-1-43-1 to -24 (Supp. 1986).

²⁵⁷*Id.* § 34-4-11.5-1. The purposes are: religion; charity; benevolence; providing goods or services at no charge to the general public; education; and scientific activities. *Id.*

²⁵⁸*Id.* § 34-4-11.5-2.

²⁵⁹*Id.*

This possibility was eliminated in 1986 when the General Assembly amended Indiana Code section 34-4-11.5-2 to provide that if no insurance policy issued to the entity provides liability coverage for the allegedly negligent act or omission of the qualified director, the qualified director is immune from civil liability for that act or omission.²⁶⁰ This amendment eliminates the possible anomaly, but might cause not-for-profit corporations to drop insurance coverage. Hopefully, however, if insurance is available at reasonable premiums, admittedly a big "if," those in a position of responsibility would resist the temptation to drop liability insurance coverage because of their own personal immunity.

²⁶⁰Act of March 3, 1986, Pub. L. No. 197-1986, § 2 (codified at IND. CODE § 34-4-11.5-2 (Supp. 1986)).

