

RECENT DEVELOPMENTS IN INDIANA CORPORATION LAW

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INTRODUCTION

Although legislative changes in Indiana corporation law in 1993 were modest, Indiana courts were confronted with several issues of interest to the practitioner resulting in some refinements and clarifications of existing law. This Article first addresses the 1993 statutory developments in the Indiana corporation law and then reviews the judicial developments in Indiana corporate law.

I. STATUTORY DEVELOPMENTS

The General Assembly in 1993 made minimal changes to the Indiana Business Corporation Law¹ (BCL), principally making minor conforming changes to accommodate the organization of limited liability companies.² Substantively, the BCL was amended to clarify the business corporation's permissive authority to purchase or maintain insurance on behalf of its present or former directors, officers, employees or agents.³ Previously, the BCL was silent on whether a corporation could purchase insurance from an affiliate or from an affiliate that is not insuring other risks. Effective July 1, 1993, a corporation may purchase insurance from, or reinsure by "an insurer that is owned by or otherwise affiliated with the corporation whether the insurer does or does not do business with other persons."⁴ In light of the General Assembly's previous policy that insurance, even insurance that goes beyond the power to indemnify, is to be permitted,⁵ the present policy is probably nothing more

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1. IND. CODE ANN. §§ 23-1-1-1 to -54-3 (Burns 1989 & Supp. 1993).

2. IND. CODE ANN. §§ 23-1-20-30(2), 23-1-37-2, 23-1-37-5(2), 23-1-37-14 and 23-1-54-3 (Burns 1989 & Supp. 1993). This Article does not discuss the Indiana Business Flexibility Act which now permits the organization in Indiana of limited liability companies. See David C. Worrell & Marci A. Reddick, *The Indiana Business Flexibility Act (Limited Liability Companies)*, 27 IND. L. REV. 919 (1994). See also Pub. L. No. 8-1993, § 301, 1993 Ind. Acts, 1970-2023 (codified at IND. CODE ANN. §§ 23-18-1-1 to -13-1 (Burns Supp. 1993)).

3. IND. CODE ANN. § 23-1-37-14 (Burns Supp. 1993).

4. *Id.* (as amended by Pub. L. No. 8-1993, § 300, 1993 Ind. Acts 1970).

5. Prior to the 1993 amendment of Indiana Code § 23-1-37-14, an Indiana corporation could purchase and maintain insurance on behalf of an individual who is or was a director, officer, employee, or agent of the corporation . . . against liability asserted against or incurred by the individual in that capacity or arising from the individual's status . . . whether or not the corporation would have the power to indemnify the individual against the same liability under section 8 or 9 [IC 23-1-37-8 or IC 23-1-37-9] of this chapter.

The amendment merely permits a corporation to purchase insurance from, or reinsure a policy by, an insurer owned or affiliated with the corporation whether or not that affiliate or subsidiary does business with any other person. Whether a corporation insured directors, officers, employees, or

than a clarification of the corporation's existing authority. Although this statutory change does not appear to alter existing rights, the courts may not give the change retroactive effect.⁶

The Indiana Nonprofit Corporation Act of 1991⁷ (the NPC) received only modest attention in the last session of the 1993 General Assembly. The NPC generally provides that three classes of corporations may take advantage of the statute: a public benefit corporation; a mutual benefit corporation; and a religious corporation.⁸ The category of public benefit corporation was expanded to include veterans' organizations, including posts, units and auxiliaries of an organization that are federally chartered for patriotic, public or charitable purposes and are recognized as being tax exempt under sections 501(c)(4) or 501(c)(19) of the Internal Revenue Code of 1986.⁹ The 1993 General Assembly also amended the statutory provisions relating to organizational meetings when initial directors are not named in the articles of incorporation. The statute, as now amended, requires the incorporator or a majority, if there are more than one, to call an organizational meeting to either elect directors and complete the organization of the corporation or to elect a board to complete the organization.¹⁰ The General Assembly also enacted a caveat to the power of a nonprofit corporation to expel or suspend a member for nonpayment of dues and assessments. Now, power cannot be exercised to affect the validity of a "mandatory" membership or a lien "imposed by a recorded declaration of covenant or a similar commitment running with the real property or an interest in the real property."¹¹ The 1993 General Assembly also imposed the NPC annual report provision on "all nonprofit domestic and foreign corporations incorporated under this article or a previous statute."¹² Exempt from this new requirement are entities currently required to file annual reports with the Secretary of State.¹³ In addition, the month—not the calendar quarter—is now used to determine the due date of the annual reports. Also, the Secretary of State was given flexibility to accept annual reports two months before the due date.¹⁴ The 1993 General Assembly made other clerical changes to the NPC,

agents by purchasing a policy from a non-affiliated company or from an affiliate would seem to be a distinction without a substantial difference.

6. See *Brane v. Roth*, 590 N.E.2d 587, 590 (Ind. Ct. App. 1992) (noting that generally statutes are not given retroactive effect unless the legislature so provides and retroactive application is disfavored where shareholders' existing rights against directors are adversely affected).

7. IND. CODE §§ 23-17-1-1 to -30-4 (Supp. 1992).

8. IND. CODE § 23-17-3-2(2) (Supp. 1992).

9. IND. CODE ANN. § 23-17-2-23(1)(D) (Burns Supp. 1993).

10. IND. CODE ANN. § 23-17-3-7(a)(2) A-B (Burns Supp. 1993).

11. IND. CODE ANN. § 23-17-7-7(a)(2) (Burns Supp. 1993).

12. IND. CODE ANN. § 23-17-27-8(a) (Burns Supp. 1993) (effective September 1, 1993).

13. *Id.*

14. IND. CODE ANN. § 23-17-27-8(d) (Burns Supp. 1993).

including small conforming changes to accommodate the organization of limited liability companies.¹⁵

II. JUDICIAL DEVELOPMENTS

A. *Derivative Actions*

In 1993, the court of appeals considered the statutes of limitation for derivative actions in *INB National Bank v. Moran Electric Service, Inc.*¹⁶ and *Browning v. Walters*.¹⁷ In both cases, the court found that the applicable statute of limitation is determined by the substance of the derivative action.¹⁸ After looking at the substance of the derivative action, the *INB National Bank* court found that the applicable statute of limitation is extended by virtue of "only legal disability, including incompetence, minority, imprisonment, non-residency under certain circumstances, war, death in certain instances, and fraudulent concealment."¹⁹ The plaintiffs in *INB National Bank* attempted to toll the statute of limitation based upon a "presidential domination"²⁰ theory that the statutory period should be tolled while the dominant president defendant controlled the corporation.²¹ The court of appeals discussed this assertion and stated that this "theory [for] tolling a statute of limitation has not been recognized in Indiana"²²

15. See IND. CODE ANN. §§ 23-17-1-4, 23-17-2-12(8), 23-17-15-3, 23-17-16-2, 23-17-16-5, 23-17-16-14, 23-17-17-4, 23-17-18-1, 23-17-19-3 and 23-17-20-1 (Burns Supp. 1993).

16. 608 N.E.2d 702 (Ind. Ct. App. 1993).

17. 616 N.E.2d 1040 (Ind. Ct. App. 1993), *reh'g granted in part*, 620 N.E.2d 28 (Ind. Ct. App. 1993).

18. 608 N.E.2d at 707, 616 N.E.2d at 1046. In *INB National Bank*, the court refused to apply the twenty-year statute to a contract evidenced by a corporate resolution, stating that the twenty-year statute of limitation period of Indiana Code Section 34-1-2-2(6) applies only to written, integrated contracts where proof problems are minimal. *Id.* (citing *Movement for Opportunity & Equality v. General Motors Corp.*, 622 F.2d 1235 (7th Cir. 1980)). The Court of Appeals applied the six-year statute of limitation from Indiana Code Section 34-1-2-1, characterizing the action as a general contract action relying on parol evidence, people's memories and extraneous documents. *Id.* (citing *International Union of United Auto, Aerospace & Agricultural Implement Workers of Am. (UAW), AFL-CIO v. Hoosier Cardinal Corp.*, 346 F.2d 242 (7th Cir. 1965), *aff'd*, 383 U.S. 696 (1966)).

19. 608 N.E.2d at 707 (citing *Walker v. Memering*, 471 N.E.2d 1202 (Ind. Ct. App. 1984)). The court of appeals noted that the circumstances under which a statute of limitation can be extended are defined by statute. *Id.* (citing IND. CODE §§ 34-1-2-5 to -9 (1988)).

20. *Id.*

21. Plaintiffs relied on *Central Railway Signal Co. v. Longden*, 194 F.2d 310 (7th Cir. 1952) (presidential dominance prevents laches); *Hill Dredging Corp. v. Risley*, 114 A.2d 697 (N.J. 1955) (laches asserted by the former president in defense); *Bentz v. Vardaman Mfg. Co.*, 210 So.2d 35 (Miss. 1968) (laches and estoppel rejected as basis for tolling where most of complained of misconduct occurred within the 6-year statute).

22. 608 N.E. at 707. The court suggested that plaintiffs-directors long acquiescence may be a breach of their own fiduciary obligations to the corporation. *Id.* at 707. See *Dotlich v. Dotlich*, 475 N.E.2d 331, 343 (Ind. Ct. App. 1985).

and that the trial court's tolling determination, made after a bench trial, was clearly erroneous.²³ The court applied the discovery rule and found that the statute of limitation did not begin to run until the resultant damage from the alleged tortious act could be ascertained through the exercise of ordinary diligence.²⁴

In *Browning*, there was no discussion of the accrual of the cause of action. Yet, because *Browning* involved a dismissal of a complaint, it appears as though the court considered the cause of action to have accrued in 1981 and 1982, when the events occurred and not necessarily when they were discovered.²⁵ Due to the Indiana Supreme Court's recent adoption of the discovery rule for personal injury actions, and its extension to claims for injury to property,²⁶ defendants in most derivative or class actions will likely be subject to the discovery rule.

The limited practical utility of the statute of limitation is further eroded by Indiana Code Section 34-1-2-9, which delays accrual of the statute of limitation when the defendant has concealed the existence of the cause of action from the plaintiff.²⁷ Ordinarily in Indiana, some affirmative action taken by the defendant is required to constitute concealment.²⁸

In a recent case involving a beneficiary's claim against a fiduciary, a trustee of an express trust, the Indiana Supreme Court held that the "plaintiff is charged with the responsibility of exercising due diligence to discover the claims."²⁹ The Indiana Supreme Court's due diligence requirement is more favorable to defendants than the holding in the court of appeal's case of *Dotlich v. Dotlich*.³⁰ In *Dotlich*, which involved a closely held corporation, a corporate director was found to have a fiduciary duty to disclose information to the corporation and to the shareholders.

The use of the discovery rule to determine when a plaintiff's cause of action accrues and the statute of limitation begins to run virtually eliminates the concealment standard provided by Indiana Code section 34-1-2-9. No longer is a plaintiff required to prove her own due diligence and defendant's active

23. *Id.* at 707-08.

24. *Id.* at 708.

25. 616 N.E.2d 1040 (Ind. Ct. App. 1993). Plaintiff *Browning* asserted a cause of action under Indiana Code § 34-4-30-1 (1988) for damages resulting from a criminal act. The court held that "the substance of a claim under Indiana Code § 34-4-30-1 is punitive rather than compensatory" and, as such, the two-year statute of limitation applied. *Id.* at 1046.

26. See *Wehling v. Citizens Nat'l Bank*, 586 N.E.2d 840 (Ind. 1992); *Malachowski v. Bank One, Indianapolis*, 590 N.E.2d 559, 564 (Ind. 1992).

27. IND. CODE § 34-1-2-9 (1988).

28. *Forth v. Forth*, 409 N.E.2d 641, 644-45 (Ind. Ct. App. 1980).

29. *Malachowski v. Bank One*, 590 N.E.2d 559, 563 (Ind. 1992).

30. 475 N.E.2d 331, 341 (Ind. Ct. App. 1985). The Court of Appeals in *INB National Bank* cited *Dotlich* for the proposition that "The statute of limitation for a cause of action against a director in a close corporation for the misappropriation of corporate assets is tolled until the director's wrongful conduct is either disclosed or discovered." *INB National Bank*, 608 N.E.2d 702, 708 (Ind. Ct. App. 1993).

concealment to toll the applicable statute of limitation. The discovery rule merely requires the plaintiff to show that she was unable to discover the harm through the exercise of ordinary diligence.³¹ In either case, the use of a discovery rule or a due diligence standard for concealment is apt to produce questions of fact making summary judgement more difficult. The result may be to increase the frequency of litigation of claims for conduct that took place years ago;³² a result in direct conflict with the purposes of statutes of limitation.³³ Because of the many opportunities that plaintiffs have to escape application of the statute of limitation and the current judicial enthusiasm for the discovery rule, the General Assembly should consider legislative repeal of the discovery rule.

The *Browning* decision contains an interesting discussion of the verification requirement of Trial Rule 23.1 for derivative actions.³⁴ In *Browning*, the plaintiff elected to stand on his unverified complaint and appeal. Initially, the court relied upon authority that failure to verify a complaint, which is required to be verified under the Trial Rules, incurs jurisdictional considerations.³⁵ The court held that the trial court properly dismissed the complaint, due to lack of jurisdiction, under Trial Rule 12(B)(6).³⁶ The *Browning* court then noted that under Trial Rules 41(B) and (E) the judgment was final and appealable and opined that such a dismissal ordinarily would not be an adjudication on the merits.³⁷ The plaintiff was entitled to elect either to amend his complaint as of right under Trial Rules 12(B)(6) and 15(A) or appeal from the order of dismissal.³⁸ The court held that *Browning's* appeal of the trial court's order dismissing his complaint "rendered the trial court's order an adjudication upon the merits."³⁹ The court noted that: "[b]y electing that course, *Browning* waived his right to amend his complaint and cannot now claim that the trial court erred in dismissing his complaint with prejudice."⁴⁰ Given the plaintiff's failure to amend and verify the complaint after the jurisdictional defect was brought to his attention, the court's initial decision, that neither the court system nor the defendants should be compelled to devote further resources to the matter, seems correct.

31. *INB Nat'l Bank v. Moran Elec. Serv., Inc.*, 608 N.E.2d 702, 708 (Ind Ct. App. 1993).

32. *Malachowski v. Bank One, Indianapolis*, 590 N.E.2d 559, 563 (Ind. 1992).

33. Those purposes are to "spare the courts from litigation of stale claims and the citizen from being put to his defence after memories have faded, witnesses have died or disappeared and evidence has been lost." *Havens v. Ritchey*, 582 N.E.2d 792, 794 (Ind. 1991).

34. *Browning v. Walters*, 616 N.E.2d 1040 (Ind. Ct. App. 1993), *reh'g granted in part*, 620 N.E.2d 28 (Ind. Ct. App. 1993).

35. 616 N.E.2d at 1044.

36. *Id.*

37. *Id.* (relying upon *City of Hammond v. Board of Zoning Appeals*, 284 N.E.2d 119, 123 (Ind. Ct. App. 1972)).

38. *Id.* at 1044-45 (relying upon *England v. Dana Corp.*, 259 N.E.2d 433, 436 (Ind. Ct. App. 1970)).

39. *Id.*

40. *Browning*, 616 N.E.2d at 1044-45.

On Browning's Petition for Rehearing, the court of appeals reconsidered the issues of whether the failure to verify a derivative action complaint as required by Trial Rule 23.1 is a jurisdictional defect, and whether the trial court erred in dismissing Browning's complaint with prejudice for failure to verify the complaint.⁴¹

Considering the jurisdictional issue, the court distinguished "jurisdiction over a particular case" from subject matter jurisdiction.⁴² The court defined jurisdiction over the case as "the right, authority, and power to hear and determine a specific case within that class of cases over which a court has subject matter jurisdiction."⁴³ As such, "a court can have subject matter jurisdiction over a class of cases and not have jurisdiction over a particular case."⁴⁴

Relying on authority, the court stated that "[w]hen a party has failed to comply with a condition precedent to maintaining an action under the Trial Rules, and another party has made a specific and timely objection, a trial court cannot exercise jurisdiction over the particular case."⁴⁵ With respect to the verification requirement of Trial Rule 23.1, the court held that such verification is jurisdictional and "the trial court was without jurisdiction to consider the merits of Browning's unverified complaint."⁴⁶ The rule requiring verification forces a petitioner to affirm the truth of his averments under the penalties for perjury.⁴⁷ If a petitioner cannot or will not comply with the verification rule, then his or her petition should be dismissed.

The court concluded that the trial court correctly dismissed Browning's unverified complaint with prejudice, but should have allowed him ten days in which to amend his complaint to comply with Trial Rule 23.1.⁴⁸ The rationale of this decision emphasizes both the importance of the pleadings when moving to dismiss a derivative action complaint due to a verification defect and the denomination of the hearing on such a motion.⁴⁹

When a complainant has failed to verify a derivative action complaint a defendant may challenge the trial court's jurisdiction over the case through a

41. *Browning v. Walters*, 620 N.E.2d 28 (Ind. Ct. App. 1993) (opinion on reh'g.).

42. *Id.* at 31.

43. *Id.* (citing *Harp v. Indiana Dep't of Highways*, 585 N.E.2d 652, 659 (Ind. Ct. App. 1992)).

44. *Id.* Clearly a plaintiff who is not willing to affirm the truth of the matters asserted in his complaint does not deserve the consideration of those unverified allegations by the court. *See* IND. R. TRIAL P. 11(B).

45. *Browning*, 620 N.E.2d at 31-32 (citing *Harp v. Indiana Dep't of Highways*, 585 N.E.2d 652, 660 (Ind. Ct. App. 1992)).

46. *Id.* at 32.

47. *See* IND. R. TRIAL P. 11(B).

48. *Browning*, 620 N.E.2d at 33.

49. In *Browning*, defendant moved for dismissal of Browning's complaint pursuant to Trial Rule 12(B)(6) and alleged Trial Rule 41(E) as grounds for dismissal, raising the failure to comply with the verification requirement of Trial Rule 23.1 as grounds.

Trial Rule 12(B)(6) motion to dismiss for failure to state a claim.⁵⁰ A motion to dismiss pursuant to Trial Rule 12(B)(6) does not require a trial court "to conduct a hearing or to give a party an opportunity to respond" prior to granting that motion.⁵¹ Also, a defendant may seek dismissal of the complaint pursuant to Trial Rule 41(E) for failure to comply with the verification requirement; such a dismissal is "with prejudice unless the trial court provides otherwise."⁵² Trial Rule 41(E) requires a hearing on the motion to dismiss prior to dismissing the action with prejudice.⁵³

Although the trial court held a hearing prior to dismissing Browning's complaint with prejudice, there was "no reference to Trial Rule 41(E) in the record in any motion or notice of hearing."⁵⁴ Thus, the *Browning* court concluded that the hearing was conducted on the defendant's Trial Rule 12(B)(6) motion and that "the specific provisions of Trial Rule 12(B)(6) allowing amendment of the complaint once as of right must control over the general provisions of Trial Rule 41(E) authorizing dismissal with prejudice for failure to comply with the Trial Rules."⁵⁵ The court of appeals allowed Browning an additional ten days to amend his complaint to comply with the verification requirements of Trial Rule 23.1.⁵⁶

The *Browning* court concluded that the dismissal by the trial court was proper.⁵⁷ Thus, if the motion and hearing had been denominated as being pursuant to Trial Rule 41(E), Browning's complaint would have been dismissed with prejudice and he would not have been given the opportunity to amend his complaint.

B. Director and Officer Liability Insurance

The Indiana Court of Appeals, in *Lexington Insurance Co. v. American Healthcare Providers*,⁵⁸ recently considered the enforceability of a provision contained in a director and officer liability insurance policy that excludes claims relating to the insolvency or liquidation of any person, including claims asserted by liquidators of insurers or Commissioners of Insurance. The plaintiffs

50. *Id.* at 31. The court also noted that because subject matter jurisdiction is not an issue, a Trial Rule 12(B)(1) motion to dismiss for lack of subject matter jurisdiction would not be proper. *Id.*

51. *Id.* at 32 (quoting *Cobb v. Owens*, 492 N.E.2d 19, 20 (Ind. 1986)).

52. *Id.* The court noted that "the failure to comply with these rules' provision found in Trial Rule 41(E) includes the failure to state a claim under Trial Rule 12(B)(6)." *Id.* (quoting IND. R. TRIAL P. 41(E)).

53. *Id.* (citing *Rumfelt v. Himes*, 438 N.E.2d 980, 983 (Ind. 1982)).

54. *Browning*, 620 N.E.2d at 33.

55. *Id.* at 33.

56. *Id.* The court noted that Browning already had almost one year in which to cure the verification defect but had not done so. *Id.* at 32.

57. *Id.* at 33.

58. 621 N.E.2d 332 (Ind. Ct. App. 1993).

consisted of directors, officers, employees, and agents of American Healthcare (American) and Physician's Choice of Northwest Indiana, Inc. (PCNI). Insurer Lexington, the defendant, provided director and officer liability insurance to American and PCNI.

In February 1989, a petition for the liquidation of PCNI was filed in the Marion Circuit Court. The acting commissioner of the Indiana Department of Insurance was appointed Liquidator of PCNI. The Liquidator filed lawsuits against the directors of PCNI (plaintiffs here) alleging breach of fiduciary duty. The Liquidator alleged that American had obtained preferential transfers from PCNI when American knew PCNI was insolvent, and that the PCNI directors participated in these preferential transfers and thus were liable for the amount of the preferences. The PCNI directors filed a declaratory judgement action claiming that Lexington had a duty to defend them in the suits and to indemnify them for any judgement rendered against them. The directors subsequently settled all claims asserted by the Liquidator. Lexington then moved for summary judgement based upon the insurance policy's exclusion of claims relating to anyone's insolvency or liquidation, including claims asserted by liquidators of insurers or Commissioners of Insurance.⁵⁹ The trial court denied Lexington's motion and certified the denial for interlocutory appeal.⁶⁰ The court of appeals reversed and remanded with instruction that summary judgement be entered in favor of Lexington.⁶¹

The court of appeals in *Lexington Insurance Co.* considered three issues: 1) whether the insurance policy exclusion was ambiguous and only applied to claims of mishandling by the liquidator; 2) whether the exclusion was void for being against public policy; and 3) whether the director plaintiffs were properly notified of the presence of the exclusion.⁶²

The court of appeals found that "[a]s the construction of a contract is a question of law, summary judgement is particularly appropriate when the terms of the contract are unambiguous."⁶³ The court's goal in interpreting the policy is "to ascertain and enforce the parties' intent as manifested in the contract for insurance" and "[w]e will not extend coverage beyond that provided in the contract and we may not rewrite the plain and unambiguous language of the insurance policy."⁶⁴ If the policy is unambiguous then it should be given its

59. The exclusion provided: "Claims based upon, arising out of, due to or involving directly or indirectly the insolvency, receivership, bankruptcy, liquidation or financial inability to pay any Insured, any Insurer or any other person, including claims brought by any insurer guarantee or insolvency fund or any receiver or liquidator of any insurer or any Commission or Superintendent of Insurance."

60. 621 N.E.2d at 335.

61. *Id.* at 341.

62. *Id.* at 335, 338, 340.

63. *Lexington Ins. Co. v. American Healthcare Providers*, 621 N.E.2d 332, 336 (Ind. Ct. App. 1993) (citing *Bicknell Minerals, Inc. v. Tilly*, 570 N.E.2d 1307 (Ind. Ct. App. 1991)).

64. *Id.* at 335 (citing *American Family Mut. Ins. Co. v. National Ins. Assoc.*, 577 N.E.2d 969

plain and ordinary meaning.⁶⁵ Finally, “[a]n insurance policy will be considered ambiguous only if reasonable persons upon reading the contract would differ as to the meaning of its terms, and an ambiguity is not established merely because one party controverts another party’s interpretation of the policy.”⁶⁶

The court of appeals held that the insurance policy’s exclusion “unambiguously applies to the lawsuits filed by the Liquidator.”⁶⁷ The policy “excludes from coverage claims involving the insolvency or liquidation of any other person, including claims brought by the liquidator of any insurer or a Commissioner of Insurance. . . .”⁶⁸ Further, the policy excludes “from coverage claims brought for acts prior to, predating, or before an insolvency or liquidation which lead to or cause an insolvency or liquidation.”⁶⁹ In sum, the plaintiffs were only insured for claims unconnected to an insolvency.

Plaintiffs argued that such an exclusion violated public policy, but could not point to any legislation in support of their claim. The court in *Lexington Insurance Co.* found that “[a]bsent contrary legislation, there is usually no public policy which prevents parties from contracting as they see fit.”⁷⁰ “[T]he power to declare a contract void for being in contravention of sound public policy is a very delicate and undefined power, and, like the power to declare a statute unconstitutional, should be exercised only in cases free from doubt.”⁷¹ Because the directors could not cite legislation that either prohibits exclusions such as were involved here, or requires companies to maintain directors and officers liability insurance, the court held that they failed to establish that the exclusion should be voided.⁷² The court found that the plaintiffs’ request “is better addressed to the General Assembly, as the legislature is the arbiter of public policy in this state.”⁷³

Plaintiffs’ final assertion was that a genuine issue of material fact existed as to whether they received proper notice of the exclusion in PCNI’s renewal policy. The directors requested the court to adopt the general rule that “requires insurers to notify insureds about changes in coverage when insurance policies are renewed.”⁷⁴ The court rejected the plaintiff’s request.⁷⁵ Yet, the court found

(Ind. Ct. App. 1991)).

65. *Id.*

66. *Id.* at 335-36 (citing *Meridian Mut. Ins. Co. v. Cox*, 541 N.E.2d 959 (Ind. Ct. App. 1989)).

67. *Id.* at 336. *See supra* note 59.

68. *Lexington*, 621 N.E.2d at 336.

69. *Id.* at 337.

70. *Id.* at 338 (citations omitted).

71. *Id.* (quoting *Corns v. Clouser*, 36 N.E. 848, 849 (Ind. 1894)).

72. *Id.* at 340.

73. *Lexington Ins. Co.*, 621 N.E.2d at 339.

74. *Id.* at 340. Plaintiffs relied on cases cited in D.C. Barrett, Annotation, *Renewal Policy - Reduction in Coverage*, 91 A.L.R.2d 546 (1963). The general rule holds that in the event no notice is given, the insureds may presume that the renewal is on the same terms as previously agreed. 621 N.E.2d at 340.

that even if such a duty were imposed then Lexington had adequately discharged that duty because its agent had provided PCNI's agent with a letter that both notified PCNI of additional exclusions and included copies of these new exclusions.⁷⁶

In reliance on *Aetna Insurance Co. v. Rodriguez*,⁷⁷ the plaintiffs argued that the notice was ineffective because "insurance brokers are considered agents of the insurer and not the insured."⁷⁸ The court distinguished *Aetna* on the grounds that, in that case, there was only one agent involved and it had dealt directly with the insurer.⁷⁹ Because PCNI's agent "did not make an application for insurance to Lexington and as they did not bind coverage for Lexington," the court concluded that *Aetna* was not applicable.⁸⁰ The court concluded that, as an agency relationship existed, notice of the change in coverage provided to PCNI's agent would be imputed to PCNI.⁸¹

Lexington reaffirms an individual's freedom to contract, and emphasizes the Indiana courts' reluctance to impose policy determinations from the bench. *Lexington* also puts directors and officers of Indiana corporations on notice that such insurance exclusions exist and that Indiana's courts will enforce those exclusions.

C. Shareholder Actions for Corporate Injury

In *Knauf Fiber Glass, GmbH v. Stein*, the Indiana Supreme Court recently considered the conditions under which it is permissible for a shareholder of a corporation to maintain an action in his or her own name to redress an injury to the corporation.⁸² The court noted that, as a general rule, such shareholder actions are not permissible because "allowing the shareholder to sue would amount to 'double counting,'"⁸³ and that Indiana had adhered to this rule for some time.⁸⁴ Indiana courts recognize an exception to the rule "when there is a breach of a duty owed specially to the stockholder separate and distinct from the duty owed to the corporation."⁸⁵

75. 621 N.E.2d at 340.

76. *Id.*

77. 517 N.E.2d 368 (Ind. 1988).

78. 621 N.E.2d at 341 (citing *Aetna Ins. Co. v. Rodriguez*, 517 N.E.2d 386 (Ind. 1988)).

79. *Id.*

80. *Id.*

81. *Id.*

82. 622 N.E.2d 163 (Ind. 1993), *rev'g in part, aff'g in part, and remanding*, *Knauf Fiber Glass, GmbH v. Stein*, 615 N.E.2d 115 (Ind. Ct. App. 1993).

83. *Id.* at 165 (citing *Mid-State Fertilizer Co. v. Exchange Nat'l Bank*, 877 F.2d 1333, 1335 (7th Cir. 1989) (Easterbrook, J.)).

84. *Id.* (citing *Tomlinson v. Bricklayer's Union*, 87 Ind. 308 (1882)). The court of appeals recognized that this rule exists "even where the corporation and the shareholder are the same." 615 N.E.2d at 125.

85. *Stein*, 622 N.E.2d at 165 (quoting *Sacks v. American Fletcher Nat'l Bank*, 279 N.E.2d

The court recognized that such a duty had been found to exist where a bank had required a shareholder to provide a personal guarantee for a loan as a condition of the bank's loan to the shareholder's corporation.⁸⁶ The court also recognized such a duty had been found to exist where a defendant had made promises directly to a shareholder, the breach of which gave rise to a cause of action.⁸⁷ The court of appeals in *Stein* found that such a duty existed and gave rise to independent liability on the part of the defendant.⁸⁸ The supreme court reversed on that issue.⁸⁹

In *Stein*,⁹⁰ Glyn Ashcraft, the plaintiff, was president and sole shareholder of Ashcraft Trucking, Inc. By 1982, Knauf Fiber Glass (KFG), the defendant, utilized Ashcraft Trucking for 75% of its shipping needs. In 1983, KFG notified Glyn Ashcraft of its intention to increase its output and of the concurrent need for more shipping capacity. KFG proposed to split the added volume equally between Ashcraft Trucking and another firm. KFG advised Ashcraft to either expand the company's trucking capacity or lose KFG's business. Glyn Ashcraft chose to expand Ashcraft Trucking's capacity and entered into a financing transaction where: 1) Glyn Ashcraft signed a personal guarantee for the loan; and 2) Knauf Fiberglass and the creditor entered into an escrow agreement, which provided that the amounts due Ashcraft Trucking for the shipment of KFG goods, would be paid into an escrow account to be applied to Ashcraft's loan.⁹¹

After acquiring the trucks, Ashcraft's business did not increase as anticipated because KFG had decided to distribute the available loads among three or four other carriers. Thus, Ashcraft Trucking sustained heavy economic losses and was forced into Chapter 7 liquidation. Glyn Ashcraft was sued on his personal guarantee and filed for bankruptcy. The bankruptcy trustee of Glyn Ashcraft's estate filed a civil action against Knauf alleging breach of contract, promissory estoppel, fraud and constructive fraud.

807, 811 (Ind. 1972)).

86. *Id.* (citing *Sacks v. American Fletcher Nat'l Bank*, 279 N.E.2d 807, 811 (Ind. 1972)).

87. *Id.* at 166 (citing *Buschmann v. Professional Men's Ass'n.*, 405 F.2d 659 (7th Cir. 1969)). In *Buschmann*, the defendant and plaintiff had entered into a pre-incorporation contract "under which the defendant was to provide management for the new corporation in exchange for plaintiff's contribution of assets and guaranty of the new corporation's debt." The court noted "the defendant made promises directly to Buschmann the breach of which gave rise to a cause of action." 405 F.2d at 663.

88. *Stein*, 615 N.E.2d at 126.

89. *Stein*, 622 N.E.2d at 166.

90. The facts are from the appellate opinions which, in turn, were based on the jury's verdict below.

91. A similar arrangement had been entered into in 1979. At that time, Knauf Fiberglass had guaranteed Glyn Ashcraft that it would commit 50% of its outbound loads to Ashcraft Trucking for the year 1979. The president of Knauf had also personally assured Glyn Ashcraft that if the trucks were acquired and the materials shipped, he would ensure Ashcraft would not go out of business. These guarantees were absent from the 1983 negotiations.

The court of appeals applied a negligence standard in determining whether Knauf owed a duty to Glyn Ashcraft.⁹² The court relied on authority that “[i]n determining whether a duty exists we must balance (1) the relationship between the parties, (2) the reasonable foreseeability of harm to the person injured, and (3) public policy concerns.”⁹³ Based upon the facts, the court of appeals found that a relationship existed between Glyn Ashcraft and Knauf “which imposed a duty on KFG separate and apart from the duty KFG owed to Ashcraft Trucking.”⁹⁴ The court determined that it was foreseeable that if Ashcraft “did not receive the increased business, then the loan for the new trucks could not be paid and creditors would call Glyn’s personal guarantee.”⁹⁵ Furthermore, “duty is not sacrosanct in itself, but is only an expression of the sum total of those considerations of policy which lead the law to say that the plaintiff is entitled to protection.”⁹⁶ The court concluded that KFG owed a duty to Glyn Ashcraft to provide additional outbound shipments of fiberglass, separate and distinct from the duty owed to Ashcraft Trucking.⁹⁷

The Indiana Supreme Court reversed.⁹⁸ The court noted that a close working relationship had developed between KFG and its personnel, and Ashcraft Trucking and Glyn Ashcraft, and that many of the communications between the firms involved Glyn Ashcraft.⁹⁹ Even so, “there was nothing in this dialogue which required Ashcraft to act in any role other than as president and stockholder.”¹⁰⁰ Furthermore, “there were no agreements or demands of the sort recognized in *Sacks* or *Buschmann*”¹⁰¹ and “no indication that KFG had asked or urged Glyn Ashcraft to give a personal guarantee.”¹⁰² The Indiana Supreme Court concluded that KFG did not owe a duty to Glyn Ashcraft separate and distinct from the duty owed to Ashcraft Trucking and that KFG was entitled to a judgment on the evidence.¹⁰³

Under *Stein*, a person must require or request a shareholder to personally incur a liability before a court will determine that a duty is owed to the shareholder separate and distinct from the duty owed to the corporation. Courts will not lightly imply that such a duty has arisen. *Stein* will protect the parties’

92. 615 N.E.2d at 125.

93. *Krauf Fiber Glass, GmbH v. Stein*, 615 N.E.2d 115 (Ind. Ct. App. 1993). The court relied on *Webb v. Jarvis*, 575 N.E.2d 992 (Ind. 1991). *Webb* involved a negligence claim alleging medical malpractice.

94. 615 N.E.2d at 126.

95. *Id.*

96. *Id.* (quoting *Webb*, 575 N.E.2d at 997).

97. *Id.* The court affirmed a damage award of \$1,722,000.

98. *Krauf Fiber Glass, GmbH v. Stein*, 622 N.E.2d 163, 166 (Ind. 1993).

99. *Id.*

100. *Id.*

101. *Id.* See *supra* notes 78-80 and accompanying text.

102. *Id.*

103. *Stein*, 622 N.E.2d at 166.

rights to negotiate without the concern that courts will imply a separate duty to a shareholder, absent some affirmative request for personal action.

D. Not-For-Profit Corporations and Personal Loan Guarantees

The court of appeals recently considered whether a not-for-profit corporation could guarantee members' loans and mortgage property to secure that guarantee in *Monsignor Bernard P. Sheridan Counsel No. 6138 Knights of Columbus v. Bagersville State Bank*.¹⁰⁴ In that case, the bank loaned \$58,000 to Mr. Schnarr, the president and director of the Knights of Columbus ("K of C"). The loan was secured by Schnarr's promissory note and backed by certain guarantees of K of C and a security interest in K of C property.¹⁰⁵ Schnarr defaulted on the loan and filed for bankruptcy. When the bank sought to enforce K of C's guarantee, K of C refused to honor the request. The bank instituted a lawsuit based on the guarantee and was granted summary judgement. K of C then appealed.

K of C first argued that the trial court erred in not finding the guarantee and mortgage were *ultra vires*, claiming execution of the guarantee and mortgage were not within its corporate powers.¹⁰⁶ The court of appeals found that "[t]he generally recognized power of a corporation to mortgage its real estate is limited to the furtherance of legitimate corporate business."¹⁰⁷ Further, "[i]t is *ultra vires* of a corporation to execute a contract of guaranty not in furtherance of its business, unless the corporation is given express authority to do so by its Board of Directors."¹⁰⁸

The court found ample authority within K of C's Articles of Incorporation to authorize its guaranty and mortgage. K of C's corporate purpose was to assist its members in time of need, and the Articles granted the K of C the "power to purchase, take, hold, lease, rent, sell or mortgage property and to do all other

104. 620 N.E.2d 732 (Ind. Ct. App. 1993).

105. Specifically, the K of C provided: 1) the absolute and unconditional guarantee of prompt and full payment of Schnarr's loan and a warranty that the guarantee was for a corporate purpose executed by K of C through Grand Knight Eugene V. Durchholz and Trustee William R. Beaver, 2) a Certificate of Resolution executed by the Finance Subcommittee of K of C authorizing Durchholz and Beaver to use specified real estate owned by K of C as collateral for Schnarr's loan and to co-sign on Schnarr's loan and certifying the corporation's and the Finance Committee's authority to adopt the resolution, 3) a collateral pledge agreement executed by Durchholz and Beaver on behalf of K of C granting the Bank a security interest in the specified real estate to secure payment of the loan, and 4) a mortgage on the specified real estate executed by Durchholz and Beaver on behalf of K of C to secure K of C's guaranty. *Id.* at 733.

106. For a discussion of challenges to corporate action of business corporations as *ultra vires* see RICHARD E. DEER, INDIANA CORPORATION LAW AND PRACTICE § 12.2 (1992).

107. *Bagersville*, 620 N.E.2d at 734 (citing *First Merchants Nat'l Bank & Trust Co. v. Murdock Realty Co.*, 39 N.E.2d 507, 513 (Ind. Ct. App. 1942)).

108. *Id.* (citing *First Merchants Nat'l Bank & Trust Co. v. Murdock Realty Co.*, 39 N.E.2d 507, 513 (Ind. Ct. App. 1942)).

things incidental, necessary, or convenient in the carrying out" of that purpose.¹⁰⁹ As such, the guaranty and mortgage were not *ultra vires* but "authorized acts in furtherance of K of C's corporate business as provided in its Articles of Incorporation."¹¹⁰

Although the *ultra vires* issue had been settled, the court of appeals went on to state that "courts do not look with favor upon the *ultra vires* defense" and "where a contract has been executed and fully performed by the corporation or the party with whom it contracted, neither party is permitted to insist the contract was not within the power of the corporation."¹¹¹ Because the bank had fully performed under an enforceable contract, K of C would have been estopped from asserting the *ultra vires* defense.¹¹²

The court summarily dismissed K of C's arguments that the execution of the guaranty, mortgage and collateral assignment was prohibited by Indiana Code sections 23-7-1.1-4(c)¹¹³ and 23-7-1.1-15¹¹⁴ of the Indiana Not For Profit Corporation Act.¹¹⁵ The court found that there was no evidence that "K of C executed the guaranty and mortgage to recompense Schnarr for an equivalent service, loss, or expense; therefore, K of C did not violate the prohibition of pecuniary remuneration to its members."¹¹⁶ Finally, "K of C's mortgage merely secured its guaranty to the Bank and was not a loan to Schnarr in violation of [Indiana Code section] 23-7-1.1-15."¹¹⁷

109. *Id.*

110. *Id.* at 735.

111. *Id.* (citing *Frank Bird Transfer Co. v. Massachusetts Bonding & Ins. Co.*, 153 N.E. 816, 818-19 (Ind. Ct. App. 1926)).

112. *Bargersville*, 620 N.E.2d at 735. The court noted that had the bank been in equal fault with K of C in an illegal contract, justice would have required leaving the parties where the court found them. *Id.* n.2. "[T]he equitable doctrine of unclean hands would have [also] prevented the Bank from foreclosing on the mortgages" if the bank had been guilty of intentional misconduct. *Id.*

113. Repealed by Pub. L. No. 179-1991 § 34, 1991 Ind. Acts 2714 (effective Aug. 1, 1991). IND. CODE § 23-7-1.1-4(c) (1988) provided "No corporation shall, by any implication or construction possess the power of engaging in any activities for the purpose of or resulting in the pecuniary remuneration to its members as such, but this provision shall not prohibit reasonable compensation to members for services actually rendered; nor shall the corporation be prohibited from engaging in any undertaking for profit so long as such undertaking does not inure to the profit of its members." Pub. L. No. 96-1993 § 19, 1993 Ind. Acts 3435 provides that the repeal of Indiana Code § 23-7-1.1 does not affect any action taken prior to the repeal. The events here occurred in January of 1988 and the statute was repealed in 1991.

114. Repealed by Pub. L. No. 179-1991 § 34, 1991 Ind. Acts at 2714 (effective Aug. 1, 1991). IND. CODE § 23-7-1.1-15 (1988) provided "No corporation shall make any advancement for services to be performed in the future or shall make any loan of money or property to any officer or director of the corporation." Note that Pub. L. No. 96-1993 § 19, 1993 Ind. Acts 3435 provides that the repeal of Indiana Code § 23-7-1.1 does not affect any action taken prior to the repeal. The events here occurred in January of 1988 and the statute was repealed in 1991.

115. Currently codified at IND. CODE §§ 23-17-1-1 to -30-4 (Supp. 1992).

116. 620 N.E.2d at 736 (citing IND. CODE § 23-7-1.1-4(c) (1988)).

117. *Id.*

The current version of the Indiana Not For Profit Corporation Act permits compensation of directors¹¹⁸ but prohibits a corporation from lending money to or guaranteeing the obligation of a director or officer of the corporation.¹¹⁹ As such, the guarantee issued by K of C would now be expressly prohibited. Although such a loan or guarantee does not affect the borrower's liability on the loan,¹²⁰ the guarantee would be worthless from the bank's perspective. The current Act also provides that not for profit corporations may "on the terms and conditions and for the consideration determined by the board of directors . . . mortgage, pledge, dedicate to the repayment of indebtedness, . . . or otherwise encumber the corporation's property whether or not in the usual course of the corporation's activities."¹²¹ As such, it appears that a not for profit corporation may still make loan guarantees, secured by corporation property, except where the beneficiary is a director or officer of the corporation. With regard to such guarantees, the principles announced in *Monsignor Bernard P. Sheridan Counsel No. 6138 Knights of Columbus v. Bargersville State Bank* are applicable.

*E. Annual Meetings*¹²²

The federal court in Indianapolis recently ordered a business corporation to conduct an annual meeting.¹²³ The court decided that it was not always necessary to wait until the statutory time period for holding annual meetings expires to make an application for a court ordered annual meeting.¹²⁴ Judge Tinder reasoned that "when a party explicitly and publicly states its intention to violate this type of law, it is unreasonable to suggest that the court may not order compliance with a law until the law is violated."¹²⁵ The court relied upon its general equitable powers¹²⁶ and Indiana's special statutory provisions permitting actions against corporations and corporate officers "to compel the performance of any duty resulting from any office, trust or station."¹²⁷

The court concluded that a board of directors' deferral of an annual meeting beyond the statutory deadline is not protected by Indiana's business judgment

118. IND. CODE ANN. § 23-17-12-15 (Burns Supp. 1993).

119. IND. CODE ANN. § 23-17-13-3(a) (Burns Supp. 1993).

120. *Id.* (b).

121. IND. CODE ANN. § 23-17-20-1(a)(2) (Burns Supp. 1993).

122. For a further discussion of the rules with respect to annual meetings, see RICHARD E. DEER, INDIANA CORPORATION LAW AND PRACTICE § 6.2(a)(1) (1991).

123. *IPALCO Enterprises, Inc. v. PSI Resources, Inc.*, No. IP 93-325-C, slip op. at 15 (S.D. Ind. June 18, 1993) (the statutory deadline for the meeting was June 30, 1993).

124. *Id.* at 7-9.

125. *Id.* at 7.

126. *Id.*

127. *Id.* (quoting IND. CODE §§ 34-1-58-1 and 34-1-58-2 (1988)). The court cited with approval *Silver v. Farrell*, 450 N.Y.S.2d 938 (N.Y. Sup. Ct. 1982) and *Ocilla Indus., Inc. v. Katz*, 677 F. Supp. 1291 (E.D.N.Y. 1987). *Id.*

rule.¹²⁸ Explicit and mandatory statutory deadlines are not viewed as matters of discretion about which the courts are prepared to permit the directors a wide latitude.¹²⁹ Although it may be proper to postpone an annual meeting when a corporate board can show a compelling justification, such contentions will be carefully scrutinized in Indiana¹³⁰ and elsewhere.¹³¹

III. CONCLUSION

Last year's reported appellate court decisions probably do not accurately predict the future which is expected to spawn cases that seek to pierce the corporate veil, to impose successor liability, or to hold individuals responsible for various actions or inactions of corporations. Most of the future controversies will probably relate to small or closely-held business corporations and fewer cases will be decided by summary judgment. Given the recent enactment of the BCL and the NPC, substantial legislative changes are not likely.

128. *IPALCO Enterprises, Inc. v. PSI Resources, Inc.*, No. IP 93-325-C at 9 (citing *Miller v. American Tele. & Tele. Co.*, 507 F.2d 759, 762 (3d Cir. 1974)).

129. *Id.* at 9-12.

130. *Id.* at 10. "No level of deference justifies a corporate board's blatant disregard of a statutory deadline." *Id.* at n.9

131. See *Aprahamian v. HBO & Co.*, 531 A.2d 1204, 1206-07 (Del. Ch. 1987); *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 661 (Del. Ch. 1988).