VI. Corporations

During the survey period several cases were decided which will have significant ramifications and, therefore, require analysis.[1]

A. Squeeze-Out Mergers

The first of these cases, *Gabhart v. Gabhart*,[2] is an example of the developing trend under state law[3] to protect minority shareholders through judicial review of corporate mergers paralleling the limiting of protection afforded by federal law.[4] The plaintiff

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[1]There were two other decisions which require a limited discussion. In Cummings v. Hoosier Marine Properties, Inc., 363 N.E.2d 1266 (Ind. Ct. App. 1977), the plaintiff attempted to utilize the doctrine of respondeat superior to impose liability on the defendant. The plaintiff asserted that the right of one defendant to supervise continuously the quality of the work was sufficient to negate the other defendant's independent contractor status. The court noted that the status between the parties was to be determined from the contract as a whole, and the independent exercise of control over the manner in which the work was to be performed was indicative of an independent contractor relationship.

In Thompson Farms, Inc. v. Corno Feed Prods., Div. of Nat'l Oats Co., 366 N.E.2d 3 (Ind. Ct. App. 1977), the court held that a principal was bound by the acts of its agent within the scope of the agency relationship. The case is interesting because it indicates two bases for establishing that agency relationship. First, under the doctrine of apparent authority, the third party must reasonably rely on a representation by the principal that the agent has authority. The court found that the principal's name was prominently displayed throughout a sales brochure, the project was personally promoted by the principal, and the principal was directly involved in the sales transaction. Thus, the plaintiff reasonably could have assumed that the defendant was the principal in the transaction. *Id.* at 12. Second, the court indicated it was possible to conclude that the defendant had contracted for a special agent and that the agent was authorized to act in pursuance of the principal's project, further signifying that the agent's acts were within the scope of his actual authority. The court rejected the defendant's contention that it could not be both the seller and the financing agency in the transaction. This distinction is recognized in some jurisdictions. *See In re* Sherwood Diversified Servs., Inc., 382 F. Supp. 1359 (S.D.N.Y. 1974); Atlas Indus., Inc. v. National Cash Register Co., 216 Kan. 213, 531 P.2d 41 (1975). For another discussion of *Thompson Farms*, see Greenberg, *Contracts, Commercial Law, and Consumer Law, 1978 Survey of Recent Developments in Indiana Law*, 12 IND. L. REV. 81, 83-86 (1978).

[2]370 N.E.2d 345 (Ind. 1977).

[3]*See, e.g.*, Bryan v. Brock & Blevins Co., 490 F.2d 563 (5th Cir.), *cert. denied*, 419 U.S. 844 (1974) (originally alleging federal securities law violations but decided under Georgia law); Jones v. H.F. Ahmanson & Co., 460 P.2d 464, 81 Cal. Rptr. 592 (1969); Singer v. Magnavox Co., 380 A.2d 969 (Del. 1977); Donahue v. Rodd Electrotype Co. 367 Mass. 578, 328 N.E.2d 505 (Mass. 1975).

[4]The extent to which the Securities Exchange Act of 1934, 15 U.S.C. § 78a-jj (1976), and, more specifically, Securities and Exchange Commission Rule 10b-5, 17 C.F.R. § 240.10b-5 (1977), will protect minority shareholders in a merger has been severely limited by the recent Supreme Court decision in Santa Fe Indus., Inc. v. Green, 430 U.S. 462 (1977). In *Green* the defendants attempted to institute a short-form

in *Gabhart* raised two novel issues under Indiana law by alleging that a squeeze-out merger in Indiana must have a legitimate business purpose to be valid and that a former shareholder can have standing to sue in a derivative action. The Seventh Circuit Court of Appeals, after noting these issues required interpretation of Indiana statutes and corporation policy, certified the questions to the Indiana Supreme Court under Appellate Rule 15(O).[5] By the *Gabhart* decision, Indiana joins the growing number of states which judicially examine statutorily conforming mergers that advance no valid business purpose and which may be unfair to minority shareholders.

In *Gabhart*, the plaintiff and the four individual defendants incorporated Washington Nursing Center, Inc., a nursing home in Washington, Indiana. Although all of the corporation's shareholders

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merger between a wholly-owned subsidiary of Sante Fe and Kirby Lumber Company, a Delaware corporation. The plaintiffs held approximately 5% of the outstanding stock of Kirby and the Santa Fe subsidiary owned the remaining 95%. The defendant attempted to merge the two corporations pursuant to § 253 of the Delaware Corporation Law which permitted a parent corporation owning at least 90% of the corporate stock of the subsidiary to merge the parent and the subsidiary with approval of only the parent's board of directors and shareholders. The minority shareholders in the subsidiary would, thus, be relegated to an appraisal remedy for their surrendered stock. The plaintiffs petitioned the state court for an appraisal of the Kirby stock but withdrew the petition and filed the federal action. The plaintiffs attempted to rescind the merger, alleging that it was effected for no valid business purpose and that the appraisal of the stock was fraudulent. They contended that the defendant's attempt to insitute the appraisal remedy at the perceived fraudulently deflated price constituted a " 'device, scheme or artifice to defraud' and engaged in an 'act, practice' or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.')" *Id.* at 467-68 (quoting 17 C.F.R. § 240.10b-5(a), (c) (1977)). The Supreme Court held that an alleged breach of fiduciary duty would support a rule 10b-5 claim only if the conduct was manipulative or deceptive within the meaning of the statute. The court noted the available state remedy provided evidence that Congress did not intend to create an implied federal cause of action if the conduct was not manipulative or deceptive. *Id.* at 478-80. The court further concluded that there had been no omission or misstatement in the documents accompanying the merger and that this full disclosure was in accord with the fundamental purpose of the Securities Exchange Act of 1934. Thus, a remedy for such conduct should not be implied where "unnecessary to ensure the fulfillment of Congress' purposes." *Id.* at 477. Most squeeze-out mergers are implemented in compliance with local corporate statutes, and the *Green* decision will mean that challenges to these mergers will not be permitted under rule 10b-5 unless the mergers are also manipulative or deceptive. The *Green* decision indicates that § 10b will not empower the federal courts to create an independent common law of fiduciary obligations. There has, however, been some support for the displacing of local law and for instead establishing a federal minimum standards act which would cover corporate fiduciary obligation. *See The Role of the Shareholder in the Corporate World: Hearings Before the Subcomm. on Citizens and Shareholders Rights and Remedies of the Sen. Comm. on the Judiciary*, 95th Cong., 1st Sess. (1977).

[5] IND. R. APP. P. 15(0).

were originally directors, the plaintiff was not able to devote sufficient time to the enterprise and resigned as a director approximately two years after incorporation.[6] The remaining directors wanted to purchase plaintiff's shares to gain total control of the corporation, but extensive discussions concerning the stock purchase proved unsuccessful. Thereupon, the majority shareholders who remained as directors attempted to acquire plaintiff's shares through a corporate restructuring merger. They formed a new corporation, the surviving company, in which they were the sole shareholders, and, as directors of both the surviving company and the merging company executed a long-form merger agreement.[7]

The specific provisions of the merger agreement provided:

> (1) The Merging Company will merge into and become a part of the Surviving Company, leaving the Surviving Company with all the property of both companies and all the rights and liabilities of both companies.
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> (2) "Any claim existing or action or proceeding pending by or against the Merging Company or the Surviving Company may be prosecuted to judgment as if the merger had not taken place or the Surviving Company may be substituted in the place of the Merging Company."
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> (3) Each shareholder of the Merging Company shall surrender his shares and receive in exchange therefor a debenture equal in amount to the number of his shares times $300, the debenture to bear interest at 7½% and to mature in 5 years.
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> (4) Each stockholder of the Merging Company shall cease to be such and "shall have no interest in or claim against the

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[6]370 N.E.2d at 348.

[7]There are two distinct types of merger which can be used in an attempt to freeze out minority shareholders. The long-form merger is more extensive and requires the approval of boards of directors of both corporations and approval of the merger by a majority of shareholders of the involved corporations. A long-form merger also requires that notice of the proceedings be given to all shareholders. *See* IND. CODE § 23-1-5-2 (1976).

A short-form merger permits a parent corporation which owns a minimum percentage of the corporate stock of a subsidiary (state laws vary on the amount of stock required) to implement a short-form merger. Many states require a minimum percentage of 90%; others, including Indiana, require 95% ownership to merge the subsidiary with the parent corporation with the approval of the parent's board of directors and usually a majority of its shareholders. The short-form merger generally does not require a shareholder vote by minority shareholders of the subsidiary or any prior notice to these minority stockholders. Indiana does not require a vote by the majority shareholders of the parent corporation, but does require notice to be sent to the shareholders of the subsidiary. *Id.* § 23-1-5-8.

> Surviving Company by reason of having been such a shareholder, except the right to receive the above described debenture."[8]

A special meeting of the merging company's shareholders was held on July 3, 1972, to vote on acceptance of the merger proposal. Ten days prior to that meeting, a notice of the meeting and a copy of the proposed merger agreement was sent, by registered mail, to the three addresses listed for the plaintiff on the corporate records. The plaintiff, however, did not actually receive the notice until one week after the meeting had taken place.[9] In the plaintiff's absence, the remaining shareholders approved the merger, and prior to the effective date of the merger, the defendants exchanged their stock in the merging company, leaving the surviving company as the majority shareholder in the merging company except for the minority interest owned by the plaintiff. Pursuant to the merger agreement, the plaintiff received the debenture for his shares in the merging company. This procedure eliminated the plaintiff from any further equity interest in either the merging company or the surviving company. The merging company was then dissolved.[10]

The plaintiff did not elect to utilize the object and demand procedure of the Indiana General Corporations Act which would have provided him an appraisal remedy.[11] Instead, before the date the merger was to become effective, he filed a diversity action against the merging company and individual defendants, alleging pecuniary injury to the corporation and charging the individual defendants with misappropriation of corporate funds. Further, the defendants were charged with denying plaintiff the opportunity to participate in corporate decisions and examine corporate records.[12] Because shareholder status is normally a prerequisite to bringing a derivative suit on behalf of a corporation,[13] the defendants moved for summary judgment asserting that the plaintiff had no standing to maintain the derivative claim. The plaintiff responded by amending his complaint to additionally charge that the merger could be attacked under Indiana law because the "sole purpose of the merger had been to deprive him of his interest in the business operated by the Merging Company."[14]

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[8]370 N.E.2d at 349.

[9]*Id.* This notice is required under IND. CODE § 23-2-5-2(a)(5) (1976). The form for such notice is set forth in *id.* § 23-1-2-9(d).

[10]370 N.E.2d at 349.

[11]IND. CODE § 23-1-5-7 (1976).

[12]*See* Great Fidelity Life Ins. Co. v. Circuit Court, 259 Ind. 441, 288 N.E.2d 143 (1972).

[13]370 N.E.2d at 356.

[14]*Id.* at 349.

1. Appraisal and the Valid Business Purpose Requirement for a Merger.—The *Gabhart* merger was consumated in procedural compliance with the merger provisions of the Indiana General Corporations Act. Despite this compliance, the plaintiff attacked the merger as having no legitimate business purpose and as being designed only to squeeze him out of the corporation.

The term "squeeze-out" is used to denote those situations in which the owners or majority of shareholders use "inside information, or powers of control, or the utilization of some legal device or technique, to eliminate from the enterprise one or more of its owners or participants."[15] The term has come to imply a purpose to force a liquidation or sale of the shareholders' shares, not incident to a legitimate business purpose[16] and normally does not contemplate an adequate compensation to the minority shareholders.[17]

Under the Indiana General Corporations Act, the dissenting shareholder in a merger may compel the surviving corporation, via the remedy known as appraisal, to purchase his shares.[18] Under the controlling statute, a shareholder who votes against the proposed merger or who does not vote may elect to use appraisal and object to the proposed merger in writing within thirty days and demand payment for his shares.[19] If the corporation and the dissenting shareholder are unable to agree on a value for the stock, then the court will compute the stock's appraised value pursuant to the procedure found within the eminent domain statute.[20] This procedure is contrary to many states' practices which specify a separate pro-

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[15]F. O'NEAL, "SQUEEZE-OUTS" OF MINORITY SHAREHOLDERS § 101, at 1 (1975). *See also* Vorenberg, *Exclusiveness of the Dissenting Stockholder's Appraisal Right*, 77 HARV. L. REV. 1189 (1964). *See generally* Brudney, *A Note on "Going Private,"* 61 VA. L. REV. 1019 (1975); Brudney & Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 HARV. L. REV. 297 (1974); Eisenberg, *The Legal Roles of Shareholders and Management in Modern Corporate Decisionmaking*, 57 CAL. L. REV. 1 (1969); Manning, *The Shareholders Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223 (1962). The squeeze-out is often called a cash-out, freeze-out or take-out merger.

[16]Vorenberg, *supra* note 15, at 1192-93.

[17]F. O'NEAL, *supra* note 15, § 1.01, at 1. Although a squeeze-out can be accomplished through several techniques, they most commonly take the form of a merger of a corporation into an existing parent or into a shell corporation formed for this purpose. *See* Brudney & Chirelstein, *A Restatement of Corporate Freezeouts*, 87 YALE L. J. 1354, 1357 (1978).

[18]IND. CODE § 23-1-5-7 (1976). The appraisal remedy has traditional roots in Indiana law and is used in mergers and consolidations. *See* State v. Bailey, 16 Ind. 46 (1861). It is also available to shareholders who dissent from "special corporate transactions" which involve the sale of all or almost all of the assets of a corporation. *See* IND. CODE §§ 23-1-6-1, -5 (1976).

[19]IND. CODE § 23-1-5-7 (1976).

[20]370 N.E.2d at 352. The procedure covering eminent domain in Indiana is codified at IND. CODE § 32-11-1-6 (1976).

cedure for the computation of the stock's appraised value based on its "fair value."[21]

Often, the majority shareholder delays payment for the tendered shares and the minority shareholders are forced to seek an injunction to halt the merger until they are compensated.[22] But the use of the injunction is discouraged and present Indiana statutes provide an exclusive procedure by which the surviving corporation of a merger is compelled to purchase the shares of the dissenting shareholders.[23] The majority of states, by statute or case law, recognize the right of appraisal as the sole relief available to a dissenting shareholder in a merger.[24] However, some recent cases question the appraisal remedy's ability to adequately compensate the minority shareholders in a squeeze-out merger.[25] In *Gabhart*, the Indiana Supreme Court recognized the possible adequacy of the appraisal remedy in the sense that a minority shareholder could receive the investment value of his interest.[26] The inability of appraisal rights to adequately compensate minority shareholders may be an additional justification for limiting the application of the remedy in a squeeze-out merger.[27]

Prior to *Gabhart*, Indiana courts adhered to the traditional rule and refused to enjoin a merger unless there was evidence of fraud or a breach of fiduciary duty. In *Raff v. Darrow*,[28] the Indiana Supreme Court stated:

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[21]*See, e.g.*, ARIZ. REV. STAT. ANN. § 10-081(k) (1977); CAL. CORP. CODE § 1300(a) (West 1977); CONN. GEN. STAT. ANN. § 33-374(d) (West 1960); DEL. CODE ANN. tit. 8, § 262(f) (1977); GA. CODE ANN. § 22-1202(g)(4) (1977); MD. CORP. & ASS'NS CODE ANN. § 3-210 (1975); NEB. REV. STAT. § 21-2080 (1977); OHIO REV. CODE ANN. § 1701.85(c) (Page 1977); PA. STAT. ANN. tit. 15, § 805 (Purdon 1967); TENN. CODE ANN. § 48-909(5) (1964); TEXAS BUS. CORP. ACT art. 15.16(E)(1) (Vernon 1977); WIS. STAT. ANN. § 180.72(2) (West 1977); MODEL BUS. CORP. ACT § 81 (1971).

The appraisal remedy is not available to the shareholders of any corporation which is the surviving corporation in a merger with respect to which no vote of the shareholders was required under the General Corporations Act, IND. CODE § 23-1-5-7 (1976), nor to the holders of shares registered on a national securities exchange on the date fixed to determine shareholders entitled to receive notice of and to vote on mergers, consolidations, or special corporate transactions unless the articles of incorporation otherwise provide. *Id.* §§ 23-1-5-7, -6-5.

[22]370 N.E.2d at 352.

[23]*Id.*

[24]H. HENN, HANDBOOK OF THE LAW OF CORPORATIONS § 349 (2d ed. 1970). The Model Business Corporation Act provides for an appraisal remedy in mergers, consolidations, and actions where the majority of a corporation's assets are transferred outside the regular course of business. *See* MODEL BUS. CORP. ACT ANN. §§ 73-74 (2d ed. 1971).

[25]*See* authorities cited in note 3 *supra*.

[26]370 N.E.2d at 354.

[27]*See* Brudney, *supra* note 15, at 1024; Vorenberg, *supra* note 15, at 1201-03.

[28]184 Ind. 353, 111 N.E. 189 (1916).

> It is the policy of the law to leave corporate affairs to the control of corporate agencies and the courts are not warranted at the suit of minority shareholders in interfering with the management of such agencies even though it may be unwise and may result in loss, except in a plain case of fraud, breach of trust, or such maladministration as works a manifest wrong to them.[29]

Some recent cases have invaded the corporate boardroom and have indicated a willingness to emphasize the fiduciary duty owed by the controlling shareholders, directors, and officers to the minority and, thus, have restricted the application of a squeeze-out merger.[30] This fiduciary duty concept implies that the majority may not exercise corporate powers if the operation simply enriches the majority at the minority's expense.[31]

There are few cases which have considered the legitimate business purpose requirement in a merger. A brief examination of some of these major cases will serve to illustrate some of the problems inherent in this analysis and provides some interesting comparisons with the approach followed by the Indiana Supreme Court in *Gabhart.*

In *Bryan v. Brock & Blevins Co.*,[32] the majority shareholders attempted to utilize a squeeze-out merger to gain total control of the corporation. Although the merger was in procedural compliance with Georgia law,[33] the court concluded that a merger could be challenged unless it was justified by a valid business purpose inherent in the merger itself.[34] The Delaware Supreme Court has recently ventured into the uncharted waters surrounding the legitimate business purpose, or lack thereof, of an otherwise statutorily valid merger. In *Singer v. Magnavox Co.*,[35] the court held

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[29]*Id.* at 360, 111 N.E. at 191.

[30]*See* cases cited in note 3 *supra* and accompanying text.

[31]The United States Supreme Court set out the standard of conduct for a fiduciary in Pepper v. Litton, 308 U.S. 295, 311 (1939):

> [The majority shareholder] cannot violate rules of fair play by doing indirectly . . . what he could not do directly. He cannot use his power for his personal advantage and to the detriment of the stockholders and creditors no matter how absolute in terms that power may be and no matter how meticulous he is to satisfy technical requirements. For that power is at all times subject to the equitable limitation that it may not be exercised for the aggrandizement, preference, or advantage of the fiduciary to the exclusion or detriment of the *cestuis.*

[32]490 F.2d 563 (5th Cir. 1974).

[33]GA. CODE ANN. § 22-1001 (1970).

[34]490 F.2d at 570.

[35]380 A.2d 969 (Del. 1977).

that a long-form merger by controlling shareholders, effected only to squeeze out minority shareholders, was a violation of the fiduciary duty that the majority shareholders owed to the minority.[36] Under the *Singer* approach, a court examining a challenged merger would analyze the entire merger process to see if the fiduciary obligation of the majority fulfilled the "entire fairness" test of *Sterling v. Mayflower Hotel Corp.*[37] The *Singer* court further held that "entire fairness" includes more than merely a valid business purpose and, even if the court were to find a legitimate business purpose, "the fiduciary obligation of the majority to the minority shareholders remains and proof of a purpose, other than such freeze-out, without more, will not necessarily discharge it."[38]

The Indiana Supreme Court in *Gabhart* was unwilling to intrude into corporate management to the same extent as the *Singer* court.[39] The court, confining the corporation to the statutory procedures outlined under the Indiana General Corporations Act, analyzed a merger without a legitimate business purpose as a "defacto corporate dissolution" and concluded that the squeeze-out merger operated as a dissolution favoring the selected majority shareholders.[40] Because a dissolution is designed to sever relationships among corporate shareholders, the court reasoned there was no justification for allowing the majority shareholders to apply the more restricted merger provisions to accomplish the same result.[41]

Consequently, under *Gabhart*, minority shareholders may challenge any offending merger as a "defacto dissolution." As the court noted: "In a dissolution, a shareholder is not limited to appraisal proceedings if he questions the fairness of the process. Rather, the liquidation and distribution of the corporate assets are subject to all principles of equity."[42] This unique analysis seems to indicate that the minority shareholders will receive fair treatment but, at the same time, it does not force the majority shareholders to offer the minority an equity interest in the new corporation. This result has been suggested in some cases.[43] In reality, though, the impact may be the same because the dissolution of a profitable corporation may be too high a price to pay for gaining complete shareholder control.

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[36] *Id.*
[37] 33 Del. Ch. 293, 93 A.2d 107 (1952).
[38] 380 A.2d at 980.
[39] 370 N.E.2d at 356.
[40] *Id.*
[41] *Id.*
[42] *Id.*
[43] *See* Singer v. Magnavox Co., 380 A.2d 969 (Del. 1977).

The Indiana Supreme Court contemplated that their "defacto dissolution" remedy would not intrude into corporate management to the extent of having every proposed merger subject to judicial review. Still, the practical effect will probably not result in a reduction of judicial review because the court is required to assess the legitimate business purpose of any merger that is attacked, and, if such purpose is lacking, it is immaterial if the remedy is an injunction to the merger or a forced recourse to the statutorily provided method of dissolution.

The *Gabhart* court concluded that, to attack a proposed merger under the defacto dissolution approach, the merger must be without any valid business purpose and must operate to reduce or eliminate the equity position of minority shareholders.[44] This dual requirement is necessary because it is not the fact that the merger is without a valid business purpose which disadvantages the minority shareholders. Rather, the elimination of the minority's equity position works the ultimate hardship.

One potential problem *Gabhart* left unresolved is whether the valid purpose test[45] should focus on the merging company or the surviving company. This problem was recognized in *Singer* where the court described the scope of the business purpose inquiry: "Is that [the business purpose] of the corporations whose shares are (or were) held by the minority? . . . And if the business purpose of the parent (or dormant) corporation should be examined . . . minority shareholders of the subsidiary (or controlled corporation) may have difficulty in raising or maintaining the issue."[46] The post-*Singer* Delaware case of *Tanzer v. International General Industries, Inc.*,[47] concluded that a legitimate purpose of a parent or surviving corporation is sufficient to validate the merger. If the scope of the business purpose test focuses only on the surviving corporation, the minority shareholders may have difficulty in asserting a lack of a legitimate business purpose.[48] Probably the most reasonable ap-

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[44]370 N.E.2d at 356.

[45]*See* Scott, *Going Private: An Examination of Going Private Transactions Using the Business Purpose Standard*, 32 Sw. L.J. 641 (1978) for a discussion of those activities which have traditionally been considered legitimate business purposes.

[46]380 A.2d at 976.

[47]379 A.2d 1121 (Del. 1977).

[48]The courts are often liberal in deciding what will constitute a legitimate business purpose. The court, in Grimes v. Donaldson, Lufkin & Jenrette, Inc., 392 F. Supp. 1393 (N.D. Fla. 1974), *aff'd mem.*, 521 F.2d 812 (5th Cir. 1975), concluded that operational efficiencies and the elimination of potential conflicts of interest are valid business purposes. If the scope of the valid business purpose test focuses on only the surviving corporation, then it will be fairly simple to show some benefit which will only accrue to the survivor.

proach is to examine the entire transaction for a legitimate business purpose.[49] The procedure will force the majority shareholders to prove the merger's necessity in advancing a legitimate business purpose before the minority shareholders have only an appraisal remedy at their disposal.

The *Gabhart* decision does not indicate if the legitimate business purpose test is also to be applied to mergers attempted pursuant to Indiana's short-form merger statute. One Delaware case[50] suggested that the purpose of the short-form merger statute is actually to eliminate minority interests, and probably the legitimate business purpose test should not be extended to cover short-form mergers.

The *Gabhart* court missed an opportunity to add some much-needed guidance to the rapidly expanding body of case law on corporate freeze-outs or squeeze-outs by failing to differentiate among the variations of such transactions. As noted by other commentators, freeze-outs seem to fall into three distinct catagories: (1) Two-step mergers (the tender offer and the merger), (2) pure going-private transactions, and (3) mergers of long-held affiliates.[51] Each of these distinct categories represent different policy considerations and, hence, require different levels of examination and different levels of minority shareholder protection. A generalized business purpose test applied to all such transactions might prove undesirable when universally applied to all fact situations.

Nonetheless, the Indiana decision in *Gabhart* is representative of the trend toward requiring a legitimate business purpose for mergers. It is important that these state remedies continue to be established now that the United States Supreme Court has refused to imply a federal cause of action for non-manipulative breaches of fiduciary obligation under rule 10b-5.

2. Standing in Derivative Actions.—In addressing the derivative claim for corporate mismanagement by the *Gabhart* plaintiff, the Indiana Supreme Court held that equitable factors may

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[49]*See, e.g.*, Bryan v. Brock & Blevins Co., 490 F.2d 563 (5th Cir.), *cert. denied*, 419 U.S. 844 (1974). The Indiana Supreme Court also failed to specify exactly which party will be required to carry the burden of proof in demonstrating that a legitimate business purpose exists. The New York Supreme Court in Tanzer Economic Assocs. Profit Sharing Plan v. Universal Food Specialties, Inc., 87 Misc. 2d 167, 383 N.Y.S.2d 472 (N.Y. Sup. Ct. 1976) placed the burden on the plaintiff. The *Gabhart* decision seems to indicate that, once the plaintiff has charged that the merger has no legitimate purpose, the surviving corporation will be required to demonstrate that the merger contains a valid business purpose.

[50]Stauffer v. Standard Brands Inc., 41 Del. Ch. 7, 187 A.2d 78 (1962).

[51]*See* Brudney & Chirelstein, *A Restatement of Corporate Freezeouts*, 87 YALE L.J. 1354 (1978); Green, *Corporate Freeze-out Mergers: A Proposed Analysis*, 28 STAN. L. REV. 487, 490-96 (1976).

allow a former shareholder to maintain a derivative suit.[52] Generally, a plaintiff in a derivative suit must be a present shareholder of the corporation whose cause of action is being pursued.[53] This requirement ensures that the shareholder-plaintiff will have at least an indirect property interest in the outcome of the derivative action because the recovery that will accrue to the corporation will enhance the value to all shareholders.[54]

In *Gabhart* the derivative cause of action which arose on behalf of the merging company was transferred to the surviving corporation along with all the corporation's other assets and liabilities.[55] Consequently, if the merging company itself is barred from asserting a claim because its cause of action is transferred to the surviving company, then the shareholders of the merging company have no derivative rights. However, if the shareholders of the merging company are made shareholders of the surviving company, there is no bar to their individual assertion of a derivative claim. The surviving company itself will usually be able to maintain such a claim, and, if the directors of the surviving company do not pursue the cause of action in the name of the surviving company, then the shareholders can invoke their own derivative claim.[56] Thus, standing is usually available in some capacity and majority shareholders or directors probably will not be able to insulate themselves from liability for personal misconduct through a merger.

However, if none of the shareholders of the surviving corporation are entitled to assert a derivative claim, equitable constraints may also prevent the successor corporation from enforcing the claim. This equitable constraint was first enumerated in the oft-cited case of *Home Fire Insurance v. Barber*[57] which was followed by the United States Supreme Court in *Bangor Punta Operations, Inc. v. Bangor & Aroostook Railroad.*[58] In *Bangor Punta* the Court held that a corporation which purchased all of the assets of another corporation, for a fair consideration, may not recover against the vendor corporation for alleged acts of corporate mismanagement if the shareholders of the purchasing corporation were not injured by the alleged wrongful activities.[59]

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[52]370 N.E.2d at 357.

[53]*See* IND. R. TR. P. 23.1.

[54]*See* Meyer v. Fleming, 327 U.S. 161, 167 (1946).

[55]*See* IND. CODE § 23-1-5-5 (1976). *See also* Heit v. Tenneco, Inc., 319 F. Supp. 884 (D. Del. 1970).

[56]Meyer v. Fleming, 327 U.S. at 167. It is irrelevant that the minority shareholders own a miniscule percentage of the corporation's outstanding shares. Ashwander v. TVA, 297 U.S. 288, 318 (1936).

[57]67 Neb. 644, 93 N.W. 1024 (1903).

[58]417 U.S. 703 (1974).

[59]There were 20 shareholders of the purchasing company who also were shareholders of the vendor corporation. The court was unwilling to let the existence of

In *Gabhart*, because all of the surviving corporation's shareholders had participated in the alleged wrongdoing, they would be unwilling to assert a claim against themselves, and, even if they did, equity would preclude the corporation from asserting any claim, and they could escape liability. However, just as courts of equity have prevented surviving corporations from succeeding to the merging company's cause of action where none of the shareholders have the requisite standing, the courts can also directly attack the merger, insuring that the wrongdoers will not escape liability and that innocent shareholders will be protected.[60]

As the *Gabhart* court noted, any merger which is attempted only to cover up wrongdoing may be attacked as having no legitimate business purpose.[61] The merger itself may have a valid motivation, but corporate misconduct can also accompany the merger and a legitimate business purpose alone should not control the liability of the wrongdoers. The *Gabhart* court concluded:

> [A] Court of Equity may grant relief, pro-rata to a former shareholder, of a merged corporation whose equity was adversely affected by the fraudulent act of an officer or director and whose means of redress otherwise would be cut off by the merger, if there is no shareholder of the surviving corporation eligible to maintain a derivative action for such wrong and said shareholder had no prior opportunity for redress by derivative action against either the merged or the surviving corporation.[62]

This reasoning indicates that the court will carefully apply equitable discretion only if the plaintiff has no other opportunity to assert the claim.

B. Successor Corporation's Liability for Product Liability Claims

In *Travis v. Harris Corp.*[63] the Seventh Circuit Court of Appeals curbed the trend of imposing liability on successor corporations for harm caused by a defective or dangerous product of the predecessor corporation.[64]

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20 minority shareholders entitle the corporation to recover damages, in the amount of $7,000,000, where the corporation would be the principal beneficiary. *Id.* at 712 n.8. For a novel discussion of potential reasons for not extending equitable constraints on standing, where creditors may be benefited by the recovery and the public can be benefited through improved railroad transportation, see the dissenting opinion of Justice Marshall.

[60] *See* Schenley Distillers Corp. v. United States, 326 U.S. 432, 437 (1946).

[61] 370 N.E.2d at 357.

[62] *Id.* at 358.

[63] 565 F.2d 433 (7th Cir. 1977).

[64] *See also* Knapp v. North Am. Rockwell Corp., 506 F.2d 361 (3d Cir. 1974), *cert. denied*, 421 U.S. 965 (1975); Cyr v. B. Offen & Co., 501 F.2d 1145 (1st Cir. 1974); Ray v.

In 1973, one of the plaintiffs in *Travis* caught his hand in a die press machine as he tried to extricate cardboard from the machine's pincher bar.[65] The die press machine was originally designed, manufactured, and sold by T.W. & C.B. Sheridan Company to Inland Container Corporation in 1957; Inland, in 1972, sold the machine to Ohio Valley Container Corporation, the plaintiff's employer. Eight years before Inland sold the die press machine to Ohio Valley, T.W. & C.B. Sheridan Company had sold most of its assets, for a cash consideration, to Harris-Intertype Corporation. Harris-Intertype formed a new subsidiary, T.W. & C.B. Sheridan Company, a new company using the name of the selling company, to receive the assets of the sale.

Subsequently, the subsidiary was merged into Harris-Intertype. In 1974 Harris-Intertype changed its name to Harris Corporation, but before that, in 1972, it had sold the assets used in manufacturing the die press and related spare parts, including the good will related thereto to the Bruno Sherman Corporation.[66] Plaintiffs filed suit against Harris and Bruno Corporations for negligence and strict liability for the design, manufacture, and distribution of the die press machine. The district court decision granted the defendants' motion for summary judgment and the plaintiffs appealed.[67]

When a corporate acquisition or transfer is structured as a merger or consolidation, the acquiring or new corporation automatically becomes liable for claims against the merging or constituent corporations.[68] Traditionally, a corporation that merely purchases the assets of another corporation for cash will not be responsible for the liabilities of the predecessor.[69] The transfer of assets is essentially a transfer of property between different entities. There are, however, four well-established exceptions to this general rule. There will be liability if: (1) The purchasing corporation expressly or impliedly agrees to assume the sellers' liabilities,[70] (2) the transaction amounts to a defacto merger or consolidation of the purchaser and seller,[71] (3) the purchasing corporation acts as a mere continuation of the seller,[72] or (4) the transaction is fraudulently entered for

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Alad Corp., 560 P.2d 3, 136 Cal. Rptr. 574 (1977); Turner v. Bituminous Cas. Co., 397 Mich. 406, 244 N.W.2d 873 (1976).

[65]565 F.2d at 445.

[66]*Id.*

[67]*Id.*

[68]*See* IND. CODE § 23-1-5-5(e) (1976).

[69]565 F.2d at 446.

[70]*See, e.g.*, Bouton v. Litton Indus. Inc., 423 F.2d 643 (3d Cir. 1970); Turnbull Inc. v. Commissioners, 373 F.2d 91 (5th Cir.), *cert. denied*, 389 U.S. 842 (1967).

[71]*See, e.g.*, Shannon v. Samuel Langston Co., 379 F. Supp. 797 (W.D. Mich. 1974).

[72]*See, e.g.*, Cyr v. B. Offen & Co. Inc., 501 F.2d 1145 (1st Cir. 1974).

the purpose of escaping liability for the seller's debts.[73]

Usually, a corporation that has sold most of its assets will usually dissolve pursuant to state statute. Even if the corporation remains intact, there might well be few assets to satisfy any potential claims. This leaves the product liability plaintiff with little alternative except to try to establish a basis of liability for the successor corporation through one of these exceptions.

The four exceptions in which the successor corporation in the sale of assets situation is held liable have traditional roots in protecting the appraisal remedy of dissenting shareholders, protecting established creditor claims, and for tax purposes.[74] Courts have extended the use of these exceptions to cover the transferee liability in products liability cases.[75]

The express or implied assumption of liability is often of little use to the products liability plaintiff. When the assumption is even mentioned, it is usually to specifically limit the liability of the purchasing corporation.[76] In *Travis* the sales contract specifically excluded the assumption of any such liability.[77]

Similarily the fourth exception, the avoidance of debts, has little application. A products liability claim is contingent and, thus, not an existing debt of the corporation when the transfer was made. Of course, a different situation exists where a corporation sells its assets after a products liability claim arises, but before any judgment is imposed.

Under the defacto merger exception, if the purchase of the assets amounts to a merger or consolidation, the purchaser assumes the liabilities of the seller.[78] Courts have consistently refused to find a defacto merger where the asset seller remains in existence, or where there was cash consideration for the sale of the assets which is available to satisfy any judgments.[79] The payment of cash consideration indicates a break in the corporate entities. Similarly, where the seller remains in existence, it indicates no intended assumption of the seller's liabilities by the purchaser which is characteristic of a merger.

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[73]*See, e.g.*, Pierce v. Riverside Mortgage Sec. Co., 25 Cal. App. 2d 248, 251, 77 P.2d 226, 229 (1938) (quoting West Tex. Ref. & Dev. Co. v. Commissioner, 68 F.2d 77, 81 (10th Cir. 1933)).

[74]*See* Note, *Assumption of Products Liability in Corporate Aquisitions*, 55 B.U. L. Rev. 86, 94-95 (1975).

[75]*See* authorities cited in note 64 *supra*.

[76]*See, e.g.*, McKee v. Harris-Seybold Co., 109 N.J. Super. 555, 264 A.2d 98 (1970), *aff'd per curiam*, 118 N.J. Super. 480, 288 A.2d 585 (1972), *overruled on other grounds*, Wilson v. Fare Well Corp., 140 N.J. Super. 476, 356 A.2d 458 (1976).

[77]565 F.2d at 445-46.

[78]*See* Forest Laboratories, Inc. v. Pillsbury Co., 452 F.2d 621, 625 (7th Cir. 1971).

[79]Kloberdanz v. Joy Mfg. Co., 288 F. Supp. 817, 821 (D. Colo. 1968).

Where two corporations are separate and distinct before and after the sale, there will be no defacto merger. In *Travis* the court treated the transfer of the assets for cash as conclusively indicative of no defacto merger.[80]

The "mere continuation" exception will impose liability on the purchasing corporation where the new entity is only a re-creation of the original entity and not merely a corporation similar with regard to various common factors.[81] The mere continuation exception also requires the continued control of individuals who managed the predecessor corporation.[82] In *Kloberdanz v. Joy Manufacturing Co.*,[83] the court found no continuation where "there was no common identity of stock, directors, or officers or shareholders . . . ."[84]

The *Travis* court noted that, although former employees of Sheridan worked for Harris, there was not the continuity of stock, stockholders, or directors required under the traditional continuity exception.[85] The purchaser and seller existed as distinct corporate entities after the sale.

Recent court decisions on transfer liability have shown a tendency to relax the traditional corporate law exceptions and place more emphasis on the policy considerations underlying strict liability. Some courts, however, appear more willing to try to expand the somewhat inflexible exceptions to fit the particular fact situations than to abandon the traditional rules.

An illustration of this trend is the Indiana Court of Appeals decision in *Cyr v. B. Offen & Co.*,[86] in which the court imposed liability on a successor corporation using the mere continuation exception[87] although, as noted above, generally there is no liability if there is a separation of ownership between the purchaser and seller.[88] The *Cyr* court recognized the applicability of using tort policy considerations in evaluating the contingent tort liability of the purchaser.[89]

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[80]565 F.2d at 447.

[81]National Dairy Prods. Corp. v. Borden Co., 363 F. Supp. 978, 980 (E.D. Wis. 1973).

[82]Lopata v. Bemis Co., 383 F. Supp. 342, 345 (E.D. Pa. 1974), *vacated*, 517 F.2d 1398 (3d Cir. 1975).

[83]288 F. Supp. 817 (D. Colo. 1968).

[84]*Id.* at 821.

[85]565 F.2d at 447.

[86]501 F.2d 1145 (1st Cir. 1974).

[87]*Id.* at 1154.

[88]*See, e.g.*, Kloberdanz v. Joy Mfg. Co., 288 F. Supp. 817 (D. Colo. 1968) (requiring common identity of stock, directors, officers, and stockholders).

[89]*See, e.g.*, Bazan v. Kux Mach. Co., 358 F. Supp. 1250 (E.D. Wis. 1973). The court noted that the successor was not the legal entity which launched the defective product into the stream of commerce. The court reasoned, however, that the purchaser profited from the goodwill the product and the corporation may have acquired. 501 F.2d at 1154.

However, the court's attempt to combine these policies into the traditional continuation corporate exception produced an unclear result. The *Cyr* decision indicates a willingness to relax, but not totally abandon, the traditional corporate law exceptions.

Other cases have rejected the attempt to fit the traditional corporate law exceptions into successor liability and focus on the policies underlying products liability. In *Turner v. Bituminous Casualty Co.*[90] the Michigan Supreme Court established a "products liability continuity principle" for gauging the degree of continuity resulting from the transfer regardless of the traditional boundaries of the corporate law exceptions.[91]

In *Ray v. Alad Corp.*[92] the California Supreme Court held that a successor corporation that continued the predecessor's same product line was liable for products liability claims arising from defective products sold by the predecessor. The court did not attempt to expand traditional corporate law exceptions to support its conclusion, but grounded its holding on the basis of the policies underlying products liability.[93] The court stated three factors which would support the liability placed on the successor corporation. First, the dissolution of the predecessor corporation will usually leave the injured plaintiff without a remedy. Second, the successor corporation is in the best position to spread the costs of the injuries on the present customers. Finally, a continued product line insures that the successor corporation will enjoy the goodwill associated with the predecessor. The court concluded that, if the successor corporation enjoys this goodwill, it must also bear the burden of the predecessor's defective products.[94] The *Ray* decision focused on the continued product line and rejected traditional corporate defenses. Instead, it attempted to incorporate the social costs of defective products into the cost of production.

The plaintiffs in *Harris* attempted to assert the *Ray* product line test, but the court declined to adopt such a far-reaching rule and concluded that such a result is best left to the legislature.[95] The court could have certified the issue to the Indiana Supreme Court which, arguably, is in a better position to evaluate Indiana's commitment to products liability and decide if an Indiana remedy for successor corporate liability is appropriate.[96]

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[90]397 Mich. 406, 244 N.W.2d 873 (1976).

[91]*Id.* at 416, 244 N.W.2d at 877-79.

[92]560 P.2d 3, 136 Cal. Rptr. 574 (1977).

[93]*Id.* at 7, 136 Cal. Rptr. at 578.

[94]*Id.*

[95]565 F.2d at 447-48.

[96]The new issue could have been certified to the Indiana Supreme Court as was done in *Gabhart. See* IND. R. APP. P. 15(0).

Although a legislative scheme might be the best method to resolve the liability of the transferee corporation, no state has yet developed such legislation. Both the *Ray* and *Turner* decisions illustrate the need to dispense with traditional corporate analysis in assessing the transfer liability of a corporation in a products liability suit and to develop rules which will impose liability in accord with the policies associated with products liability. An expansion of the corporate law exceptions will only inhibit their usefulness and certainty for the original purposes for which they were intended.

C. Capacity To Be Sued: Unincorporated Associations

In *O'Bryant v. Veterans of Foreign Wars, No. 1552,*[97] the Indiana Court of Appeals held that a member of an unincorporated association can sue the association for negligence. The plaintiff brought suit against the VFW for bodily injuries allegedly suffered because of the VFW's negligence. The trial court granted defendant's motion for summary judgment, adhering to the traditional rule which prohibits the individual members of an unincorporated association from suing the association in tort.[98]

The traditional rule of non-liability for an association is grounded on concepts dealing with partnerships. A partnership is formed by individual members who each control the operations of the partnership, and each partner represents the partnership in the transaction of its business. The members of an unincorporated association are similar to the partnership parties in that they, too, form the association and have the legal right to control the business of the association. In such a joint enterprise each individual is both principal and agent for all the members of the association and the negligence of any member will then be imputed to all of the members.[99]

These technical factors will often have little relevance to a modern unincorporated association because the association's business is likely to be carried out through elected officials, and the individual members have little input in association decisions or exert little control over the association's daily operations.

Both California, in *White v. Cox,*[100] and Ohio, in *Tanner v. Columbus Lodge No. 11, Loyal Order of Moose,*[101] have rejected the tradi-

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[97]376 N.E.2d 521 (Ind. Ct. App. 1978).

[98]*Id.* at 522.

[99]*See* Marshall v. International Longshoremen's & Warehousemen's Union, 371 P.2d 987, 22 Cal. Rptr. 211 (1962).

[100]17 Cal. App. 3d 824, 95 Cal. Rptr. 258 (1971).

[101]44 Ohio St. 2d 49, 337 N.E.2d 625 (1975).

tional rule and have held that an unincorporated association is entitled to general recognition as a separate legal entity apart from its members and, thus, a member of the association can sue the association in tort. To help support its conclusion, the *White* court noted the development of California statutory and case law limiting the liability of individual members for the debt of the association.

Similarly, the court in *O'Bryant* placed substantial emphasis on Indiana Trial Rule 17(E) which states:

> A partnership or an unincorporated association may sue or be sued in its common name. A judgment by or against the partnership or unincorporated association shall bind the organization as if it were an entity. A money judgment against the partnership or unincorporated association shall not bind an individual partner or member unless he is named as a party or is bound as a member of a class in an appropriate action.[102]

The court noted that Trial Rule 17(E) can be effective as a rule of both procedural and substantive law and concluded that an unincorporated association should be an artifical entity separate from the members.[103] In this way associations can still serve as "principals of their officers, agents, and employees without need to resort to the fiction that the members of the association are the principals."[104]

D. Statutory Developments

The Indiana General Assembly produced no noteworthy statutory developments in the corporation law area. However, the recent decision of the Fifth Circuit Court of Appeals in *Great Western United Corp. v. Kidwell*,[105] affirming a district court's ruling holding the Idaho Corporate Takeover Act[106] unconstitutional, casts doubt on the constitutionality of all state statutes regulating corporate tender offers[107] including the Indiana Business Takeover

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[102]IND. R. TR. P. 17(E).

[103]376 N.E.2d at 523.

[104]*Id.*

[105][1978] FED. SEC. L. REP. (CCH) ¶ 96,529 (5th Cir. Aug. 10, 1978).

[106]IDAHO CODE §§ 30-1501 to 1513 (Supp. 1977).

[107]The following states have enacted statutes regulating corporate takeovers: ALASKA STAT. §§ 45.57.010 - .120 (Supp. 1976); COLO. REV. STAT. §§ 11-51.5-101 to 108 (Supp. 1976); CONN. GEN. STAT. §§ 36-347a to 347n (Supp. 1976); DEL. CODE ANN. tit. 8, § 203 (Supp. 1977); 1977 Fla. Laws ch. 77-441; GA. CODE ANN. §§ 22-1901 to 1915 (Supp. 1977); HAWAII REV. STAT. §§ 417E-1 to 15 (1976); IDAHO CODE §§ 30-1501 to 1513 (Supp. 1978); IND. CODE §§ 23-2-3-1 to 12 (1976 & Supp. 1978); KY. REV. STAT. §§ 292.560 - .630 (Supp. 1976); LA. REV. STAT. ANN. §§ 51:1500 - :1512 (West Supp. 1978); MD. CORPS. & ASS'NS CODE ANN. §§ 11-901 to 908 (Supp. 1977); MASS. ANN. LAWS ch. 110C, §§ 1 - 13

Act.[108]

In 1971, Great Western United, a Delaware corporation, announced a tender offer for 2,000,000 shares[109] of the stock of Sunshine Mining Company. Sunshine Mining was incorporated under Washington law but over fifty percent of its assets and its corporate headquarters were located in Idaho.[110] Great Western initially complied with the disclosure requirements of the Williams Act amendments to the Securities Exchange Act of 1934[111] and then attempted to comply with the more stringent disclosure provisions of the Idaho takeover law. After the Idaho Securities Commissioner determined that the disclosed information was inadequate, Great Western filed suit to prevent the enforcement of the statute, alleging that the state law was pre-empted by the provisions of the Williams Act and placed an undue burden on interstate commerce. The district court found the statute unconstitutional on both grounds,[112] and the decision was appealed.

After resolving several procedural issues,[113] the court first addressed the pre-emption issue.[114] This doctrine gives effect to the

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(Michie/Law Co-op Supp. 1977); MICH. COMP. LAWS ANN. §§ 451.910 - .917 (Supp. 1977); MINN. STAT. ANN. §§ 80B.01 - .13 (West Supp. 1978); MISS. CODE ANN. §§ 75-72-1 to 23 (Supp. 1977); NEV. REV. STAT. §§ 78.376 - .3778 (1973); N.H. REV. STAT. ANN. 421-A-1 to A-15 (1977); N.Y. BUS. CORP. LAWS §§ 1601 - 1613 (McKinney Supp. 1977); OHIO REV. CODE ANN. § 1707.041 (Page Supp. 1978); PA. STAT. ANN. tit. 70, §§ 71 - 85 (Purdon Supp. 1978); S.D. COMPILED LAWS ANN. §§ 47-32-1 to 47 (Supp. 1978); TENN. CODE ANN. §§ 48-2101 to 2114 (Supp. 1977); UTAH CODE ANN. §§ 61-4-1 to 13 (Supp. 1976); VA. CODE §§ 13.1-528 to 541 (1978); WIS. STAT. ANN. §§ 552.01 - .25 (West 1978). *See generally* Galanti, *Business Associations, 1977 Survey of Recent Developments in Indiana Law*, 11 IND. L. REV. 27 (1977).

[108]IND. CODE §§ 23-2-3-1 to 12 (1976 & Supp. 1978).

[109]The offer represented approximately 35% of Sunshine's outstanding stock. Sunshine's board of directors, dissatisfied with Great Western's offer of $15.75 per share, characterized the offer as "unfriendly."

[110]Under IDAHO CODE § 30-1501(6) (Supp. 1978), the Idaho Takeover Act applied if the target company had a substantial portion of its assets or its principal office in Idaho.

[111]15 U.S.C. §§ 78m(b) - (c), 78n(d) - (f) (1976).

[112]439 F. Supp. 420 (N.D. Tex. 1977). The court of appeals decision elicited national interest and *amici curiae* briefs were filed on behalf of Connecticut, Ohio, Mississippi, Louisiana, New York, Utah, and the Securities and Exchange Commission.

[113]Among the plethora of defenses to Great Western's suit were jurisdiction, venue, and service. All defenses were rejected by the court. [1978] FED. SEC. L. REP. (CCH) ¶ 96,529, at 94,095-102.

[114]In 1968 Congress enacted the Williams Act, the principle federal statute which regulates the use of cash tender offers and which may pre-empt a corresponding state statute. The use of cash tender offers increased from under 10 in 1960 to over 100 in 1966. *See* E. ARANOW & H. EINHORN, TENDER OFFERS FOR CORPORATE CONTROL 65 n.3 (1973). The Williams Act was designed to provide information to investors so they would be reasonably informed of the substance of the tender offer and could then make a better-reasoned decision. The Act requires the corporation making the tender offer to disclose to the SEC its background, the course and amount of the considera-

supremacy clause of the United States Constitution.[115]

The court recognized that Congress did not intend to completely exclude all state regulation of securities. Section 28 of the Securities Exchange Act of 1934[116] provides that state securities regulation is permissible as long as it does not conflict with federal law. Even if federal law does not completely exclude state regulation, however, the state statute must fail if it conflicts with the federal statute and frustrates the full purposes and objectives of Congress.[117]

After identifying the relevant criterion to be applied, the court analyzed the purposes of the Williams Act. The court concluded the recent Supreme Court decision in *Piper v. Chris-Craft Industries, Inc.*,[118] held that the primary purpose behind the Williams Act is to protect investors. The Supreme Court noted in *Piper* that neutrality between the target company and the corporation attempting the takeover is but one of the characteristics toward protecting investors.[119]

State corporate takeover statutes generally require disclosure of more information than is required under the Williams Act,[120] and provide that the disclosure be made before the effective date of the tender offer.[121] The Idaho takeover statute also provided for a hearing to determine the fairness of the tender offer.[122] The *Great Western* court found that the Idaho statute increased a target company's ability to defeat a tender offer. The court identified the advance notice of the tender offer, the ability to delay the offer through the use of a hearing, and the ability of the target corpora-

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tion, any other interests held in the target company, and the purpose of transaction. The post-effective waiting period gives the shareholders a chance to make their informed investment decisions.

[115]U.S. CONST. art. VI, cl. 2. *See* Goldstein v. California, 412 U.S. 546 (1973); Hines v. Davidowitz, 312 U.S. 52 (1941).

[116]15 U.S.C. § 78bb(a) (1976). *See* SEC v. National Sec. Inc., 393 U.S. 453, 461 (1969). Section 28 of the Securities Exchange Act of 1934 has been widely used to help justify the existence of state takeover laws. When the Williams Act was promulgated, only one state, Virginia, had a corporate takeover law. Thus, it can be argued that, although § 28 preserves existing Blue Sky laws, there was no intent to preserve the later adopted takeover laws.

[117][1978] FED. SEC. L. REP. (CCH) ¶ 96,529, at 94,102-03.

[118]430 U.S. 1 (1977).

[119]*Id.* at 29.

[120]Schedule 13D was the disclosure form required for Great Western when it made its tender offer. The current required disclosure form is Schedule 14D. *Compare* Schedule 14D-1, 17 C.F.R. § 240.14d-4 (1977) *with* IND. CODE § 23-2-3-2 (1976).

[121]*See, e.g.*, IND. CODE § 23-2-3-2(b) (1976).

[122]IDAHO CODE § 30-1503(4) (Supp. 1978). Idaho is not alone in the hearing requirement. *See, e.g.*, IND. CODE § 23-2-3-2(e) (1976); MINN. STAT. ANN. § 80B.03 subd. 4 (West Supp. 1978); VA. CODE § 13.1-531(a) (Supp. 1978); WIS. STAT. ANN. §§ 552.05(4) - (5) (West 1978).

tion's board of directors to exclude the offer from state regulations by approving the offer as factors weighing in favor of the target company's management.[123] The Idaho Director of Finance[124] asserted that these pro-management provisions were not meant to prevent tender offers but instead to help directors fulfill their fiduciary duties to shareholders by allowing additional time to assess the tender offer. This novel "fiduciary approach" to investor protection was unpersuasive to the court. It held that the Williams Act contemplated a "market approach" to investor protection where the investor and not the management of the target company evaluates the tender offer.[125] These elements were more than enough to convince the court that the Idaho statute conflicted with the Williams Act and was thereby pre-empted.[126]

After deciding the pre-emption issue, the court examined the Idaho statute to see if it imposed an undue burden on interstate commerce. The commerce clause[127] is designed to promote flexibility and commercial activity between states.[128] The interstate movement of securities is within the scope of the commerce clause. In determining if a state law unreasonably burdens interstate commerce, the court used the analysis found in *Pike v. Bruce Church, Inc.*,[129] first examining to see if the law promoted a legitimate local interest, then assessing the burden the law placed on interstate commerce, and, finally, balancing the burden and the benefit.

The court noted that any attempt to justify the Idaho legislation based on safeguarding the local economy would fail, but accepted the regulation of changes in management, by outsiders, as a legitimate local interest.[130] The incumbent management of the corporation has an impact on local lifestyle through various civic activities and may be more responsive to local interests than would outside management. The court accepted the regulation of the

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[123][1978] FED. SEC. L. REP. (CCH) ¶ 96,529, at 94,105.

[124]The original defendant in the district court case, Thomas L. Kidwell, the Attorney General of Idaho, elected not to appeal the case.

[125][1978] FED. SEC. L. REP. (CCH) ¶ 96,529, at 94,106.

[126]The court concluded that the provisions of the Idaho law would cause delay for the acquiring corporation and that delay is one of the most effective means of defeating a tender offer. *Id.* at 94,105. *See also* D. AUSTIN & J. FISHMAN, CORPORATION IN CONFLICT: THE TENDER OFFER 127 (1970); Wilmer & Landy, *The Tender Trap: State Takeover Laws and Ther Constitutionality*, 45 FORDHAM L. REV. 1, 9 (1976-77). Prior courts have also noted that delay is the target company's strongest ally. Copperheld Corp. v. IMETAL, 403 F. Supp. 579, 608 (W.D. Pa. 1975).

[127]U.S. CONST. art. I, § 8, cl. 3.

[128]*See* National Bellas Hess, Inc., v. Department of Revenue, 386 U.S. 753, 760 (1967).

[129]397 U.S. 137 (1970).

[130][1978] FED. SEC. L. REP. (CCH) ¶ 96,529, at 94,109.

means by which outsiders can change management as a legitimate local interest.[131] This interest may be significant, especially in smaller Indiana communities where local management can have a significant impact on local lifestyle.

It was also argued that the Idaho takeover law was designed to protect investors. While accepting this as a legitimate purpose, the court noted that Idaho had little reason to protect shareholders of other states unless the securities transaction took place in Idaho or would substantially affect Idaho's shareholders.[132] Only about two percent of Sunshine Mining's shareholders resided in Idaho. The state had a local interest in protecting these shareholders but, even if no shareholders had resided in Idaho and no securities transaction had taken place in Idaho, the takeover law still would have applied because Sunshine had fifty percent of its assets and its principal place of business within the state boundaries of Idaho.[133]

In examining the burden on interstate commerce, the court concluded that the Idaho statute disrupted normal securities markets through the advance notification procedure,[134] and, in this case, the court noted that the Idaho statute effectively stopped over thirty-one million dollars of interstate commerce.[135] The requirements of a state exercising control over a tender offer will prevent an acquiring company from making any tender offer until the state requirements are satisfied.

When the court attempted to balance the interest and the burden, the result was apparent. The local interest in protecting Idaho investors, in this case a very small percentage of the shareholders, and the indirect and incidental interests of corporate civic responsibility through fuller disclosure were not persuasive when weighed against Idaho's extraterritorial regulation of tender offers which could interfere with securities transactions all over the country. Thus, the court concluded the Idaho statute imposed an undue burden on interstate commerce.[136]

If the Fifth Circuit Court of Appeal's result is affirmed on appeal to the United States Supreme Court, it seems apparent that the Indiana Business Takeover Act is also unconstitutional. The Indiana Act requires substantially more disclosure than the provisions of the Williams Act. In addition, Indiana also provides for a hearing

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[131] *Id.*

[132] *Id.*

[133] *Id.* The Indiana Business Takeover Act also applies if a target company is organized under Indiana law, has its principal place of business in Indiana, or has a substantial portion of its total assets in Indiana. IND. CODE § 23-2-3-1(j) (1976).

[134] [1978] FED. SEC. L. REP. (CCH) ¶ 96,529, at 94,109.

[135] *Id.* at 94,110.

[136] *Id.* at 94,112.

and seems to follow the "fiduciary approach" rejected by the *Great Western* court by excluding tender offers approved by the board of directors of the target company from the definition of a "takeover offer."[137] Finally, the Indiana law also does not require that a majority of the shareholders of the target company reside in Indiana. Instead, the Indiana statute may be effective where the target company was incorporated in Indiana, or had its principal place of business in Indiana, or had a substantial portion of its assests in Indiana.[138]

LEX L. VENDITTI

VII. Criminal Law and Procedure

*Richard P. Good**

The decisions discussed in this Article deal solely with criminal procedure. There have been no appellate decisions on substantive criminal law under the new Indiana Penal Code[1] which became effective October 1, 1977. The discussion is presented in the general order in which the respective issues would arise in the various stages of the criminal process, beginning with pre-trial issues and continuing with issues pertaining to the trial and post-trial stages. In addition, several significant amendments to the penal code during the 1978 session of the General Assembly will be discussed.[2]

A. Search and Seizure

1. Arrest Warrants.—There are two contrary lines of cases in Indiana on whether warrantless arrests are proper absent exigent circumstances.[3] One holds that, in order to have a valid warrantless arrest for a crime not committed in the presence of the officer, there must be probable cause to believe that a crime was committed

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[137]IND. CODE § 23-2-3-1(i)(5) (1976).

[138]*Id.* § 23-2-3-1(j).

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The author wishes to express his appreciation to Paul H. Ellison for his assistance in the preparation of this Article.

[1]IND. CODE § 35-1-1-1 to 50-6-6 (Supp. 1978).

[2]*See* notes 275-88 *infra* and accompanying text.

[3]*See* Kerr, *Criminal Law and Procedure, 1975 Survey of Recent Developments in Indiana Law*, 9 IND. L. REV. 160, 162 (1975).