

III. Business Associations

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A. Securities Act Derivative Liability

Arnold v. Dirrim,¹ the most significant business associations case decided during the survey period, brings home with a vengeance the adage that "ignorance of the law is no defense." In *Arnold*, the Indiana Court of Appeals affirmed a class action judgment holding Arnold, a director of National Guaranty Corporation (NGC), derivatively liable to NGC shareholders under section 23-2-1-19(b)² of the Indiana Securities Act.³

The complaint, originally filed against NGC and its president, alleged that the plaintiffs had purchased NGC shares pursuant to a false and misleading prospectus. An amended complaint was filed that added NGC officers and directors, including Arnold, as defendants and sought permission to bring the suit as a class action on behalf of all purchasers of NGC shares after October 15, 1969.⁴ The

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¹398 N.E.2d 426 (Ind. Ct. App. 1979).

²IND. CODE § 23-2-1-19(b) (1971) (current version at IND. CODE § 23-2-1-19(b) (1976)).

This section read as follows when the *Arnold* cause of action arose:

Every person who directly or indirectly controls a seller liable under subsection (a) [IND. CODE § 23-2-1-19(a)], every partner, officer or director of such a seller, every person occupying a similar status or performing similar functions, every employee of such a seller who materially aids in the sale, and every broker-dealer or agent who materially aids in the sale are also liable jointly and severally with and to the same extent as the seller, unless the nonseller who is so liable sustains the burden of proof that he did not know, and in exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist. There is contribution as in cases of contract among the several persons so liable.

IND. CODE § 23-2-1-19(b) was amended in 1975 by substituting the words "seller or purchaser" for "seller" and "sale or purchase" for "sale," thus extending civil liability to purchasers as well as sellers of securities. The amendment was not material to the *Arnold* decision. 398 N.E.2d at 430 n.1. See generally Galanti, *Business Associations, 1975 Survey of Recent Developments in Indiana Law*, 9 IND. L. REV. 33, 63 (1975) [hereinafter cited as Galanti, *1975 Survey*]. Before the 1975 amendment, IND. CODE § 23-2-1-19(b) was identical to UNIFORM SECURITIES ACT (U.L.A.) § 410(b) (Master Ed. 1978).

³IND. CODE §§ 23-2-1-1 to -24 (1976 & Supp. 1980). For discussions of the Indiana Securities Act see generally Boehm, *Federal Business Law and the Indiana Lawyer: The Impact of the Securities Law on the General Practitioner*, 48 IND. L. J. 216 (1973); Pamas, *Securities Issuance and Regulation: The New Indiana Securities Law*, 38 IND. L. J. 38 (1962); Note, *Securities Registration Requirements in Indiana*, 3 IND. LEGAL F. 270 (1969); Doxsee, *Securities Problems in Indiana*, 17 RES GESTAE No. 9, at 6 (1973).

⁴398 N.E.2d at 430.

amended complaint alleged that sales of NGC shares after October 15, 1969, were made pursuant to a false, misleading, and inadequate prospectus in violation of Indiana Code section 23-2-1-19(a).⁵ In addition, the amended complaint alleged that shares sold after the prospectus expired on October 15, 1970, were unregistered; therefore, the sale of these shares was in violation of section 23-2-1-3.⁶ Arnold was held liable for sales of NGC shares during both periods.⁷

⁵IND. CODE § 23-2-1-19(a) (1971) (currently codified at IND. CODE § 23-2-1-19(a) (1976)). Before the section was amended in 1975, it provided that:

(a) Any person who

(1) offers or sells a security in violation of sections 201 [*Id.* § 23-2-1-3], 204(d) [*Id.* § 23-2-1-5(d)], 301(a) [*Id.* § 23-2-1-8(a)] or 502(b) [*Id.* § 23-2-1-14(b)]; or

(2) offers or sells a security by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading (the buyer not knowing of the untruth or omission), and who does not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of the untruth or omission, is liable to the person buying the security from him, who may sue either at law or in equity to recover the consideration paid for the security, together with interest at six per cent per year from the date of payment, costs, and reasonable attorneys' fees, less the amount of any income received on the security, upon the tender of the security and any income received on it, or for damages if he no longer owns the security. Damages are the amount that would be recoverable upon a tender less the value of the security when the buyer disposed of it and interest at six per cent per year from the date of disposition.

Section 23-2-1-19(a) was similar but not identical to UNIFORM SECURITIES ACT (U.L.A.) § 410(a) (Master Ed. 1978). IND. CODE § 23-2-1-19(a) (1976) now provides that:

Any person who offers, purchases or sells a security in violation of any of the provisions of this chapter, and who does not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of the violation, is liable to any other party to the transaction, who did not knowingly participate in the violation or who did not have, at the time of the transaction, knowledge of the violation, who may sue either at law or in equity to rescind the transaction or to recover the consideration paid, together, in either case, with interest at eight percent (8%) per year from the date of payment, costs, and reasonable attorneys' fees, upon the tender of the security or consideration received by the person bringing the action.

Although the specific language of § 23-2-1-19(a) has changed, the same result would be reached if *Arnold* were brought today.

⁶IND. CODE § 23-2-1-3 (1976) makes it "unlawful for any person to offer or sell any security in this state unless (1) it is registered under this act [§§ 23-2-1-1 to -25] or (2) the security or transaction is exempted under section 102 [§ 23-2-1-2]." This provision is identical to UNIFORM SECURITIES ACT (U.L.A.) § 301 (Master Ed. 1978).

IND. CODE § 23-2-1-5(d) (1976) requires that "[s]o long as any offering continues, the prospectus shall be revised and brought current by the filing of an amended prospectus at least once every twelve (12) months after the registration statement becomes effective and so long as the offering is not discontinued."

⁷398 N.E.2d at 430.

Before a corporate director who is not an actual seller of securities can be held liable derivatively under section 23-2-1-19(b), the corporation or actual seller must have made a sale proscribed by section 23-2-1-19(a).⁸ The trial court found that NGC's prospectus⁹ was misleading, and therefore in violation of section 23-2-1-19(a),¹⁰ because it failed to adequately disclose: (1) material transactions between NGC and a second corporation controlled by NGC's directors; (2) circumstances of the second corporation's acquisition, control, and resale of NGC shares, including how the second corporation had "created" the market price for NGC shares; (3) material transactions between NGC and a third corporation; and (4) the NGC directors' indirect ownership of NGC shares through various entities.¹¹

The court of appeals agreed with the trial court's conclusion that the prospectus was inadequate and misleading¹² in omitting in-

⁸IND. CODE § 23-2-1-19(a) (1976). Although the complaint alleged in part that NGC sold unregistered securities and the court referred to selling unregistered securities, 398 N.E.2d at 430, 435, there was no actual discussion whether such sales were in fact made. Either this point was not pursued by Arnold or, because Arnold was appealing from a negative judgment, the court concluded there were no grounds upon which he could appeal this point. A negative judgment will not be reversed unless it is contrary to law. *Id.* at 434; *see* Kroger Co. v. Haun, 379 N.E.2d 1004 (Ind. Ct. App. 1978). Furthermore, a decision of a trial court will not be disturbed as "contrary to law" unless the trial court reached a conclusion contrary to the only conclusion that can be drawn from the evidence. *See* Umbreit v. Chester B. Stem, Inc., 373 N.E.2d 1116 (Ind. Ct. App. 1978); Chaney v. Tingley, 366 N.E.2d 707 (Ind. Ct. App. 1977). *See generally* 4A B. BAGNI, L. GIDDINGS & K. STROUD, INDIANA PRACTICE, APPELLATE PROCEDURE § 107 (1979) [hereinafter cited as BAGNI, GIDDINGS & STROUD].

⁹Securities can be registered for sale under the Indiana Securities Act in two ways. Securities being offered pursuant to a registration statement filed under the federal Securities Act of 1933, § 5, 15 U.S.C. § 77e (1976), may be "registered by coordination" under IND. CODE § 23-2-1-4 (1976). Under this procedure, the primary documents filed with the Indiana Securities Commissioner are copies of the form of prospectus filed with the Securities and Exchange Commission, *id.* § 23-2-1-4(b)(1), although the Indiana Securities Commissioner may require or request other documents and information. *Id.* §§ 23-2-1-4(b)(2)-(4), (c)(2)-(5).

If the securities are not being offered pursuant to a registration statement and prospectus filed under the federal Securities Act of 1933, IND. CODE § 23-2-1-5 (1976) specifies in far more detail the information and documents which must be filed with the Indiana Securities Commissioner in a "registration by qualification." The offering in *Arnold* apparently was not subject to the Securities Act of 1933; therefore, the registration should have been in compliance with *id.* § 23-2-1-5. For a discussion of the registration requirements under the Indiana Securities Act, *see generally* authorities cited in note 3 *supra*. *See also* I, IV L. LOSS, SECURITIES REGULATION 49-61, 2222-34 (2d ed. 1961 & Supp. 1969) [hereinafter cited as LOSS]; J. MOFSKY, BLUE SKY RESTRICTIONS ON NEW BUSINESS PROMOTIONS 59-72 (1971).

¹⁰IND. CODE § 23-2-1-19(a) (1976).

¹¹398 N.E.2d at 431.

¹²*Id.* at 433.

formation specifically required by section 23-2-1-5(b).¹³ The court also found that the prospectus failed to comply with a rule of the Indiana Securities Commissioner¹⁴ requiring a prospectus to contain information not expressly required by the Act which is necessary under the circumstances to make the prospectus not misleading.¹⁵ Furthermore, the antifraud provision of the Indiana Securities Act prohibits the omission of material facts "necessary in order to make the statements made in the light of the circumstances under which they are made, not misleading,"¹⁶ and section 23-2-1-19(a), as it was phrased when *Arnold* arose, specifically provided for civil liability when "material" facts were not disclosed in a sales transaction if the buyer was unaware of the omission.¹⁷

An omitted fact must be "material" before civil liability will be imposed under the Indiana Securities Act.¹⁸ The Act does not, however, define the term "material."¹⁹ The *Arnold* court, relying on *Holmes v. Bateson*,²⁰ concluded that the "central consideration in determining materiality is whether a reasonable investor would attach importance to the information when deciding on his course of action."²¹ No Indiana authority for the appropriate test for "materiality" was cited. Although several decisions under the Indiana

¹³IND. CODE § 23-2-1-5(b) (1976).

¹⁴*Id.* § 23-2-1-5(b)(1)(P) authorizes the adoption of such rules.

¹⁵710 IND. AD. CODE 1-2-7(d) (1979).

¹⁶IND. CODE § 23-2-1-12 (1976). This section, which is similar to UNIFORM SECURITIES ACT (U.L.A.) § 101 (Master Ed. 1978), in full provides:

It is unlawful for any person in connection with the offer, sale or purchase of any security, either directly or indirectly, (1) to employ any device, scheme or artifice to defraud, or (2) to make any untrue statements of a material fact or to omit to state a material fact necessary in order to make the statements made in the light of circumstances under which they are made, not misleading, or (3) to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person.

¹⁷IND. CODE § 23-2-1-19(a) (1976), as it is currently worded, does not specify the particular acts which result in civil liability but rather imposes such liability for a "violation of any of the provisions of this chapter." The same standards, however would apply.

¹⁸The Indiana Securities Act phrases certain facts that must be contained in a prospectus in terms of materiality. *E.g.*, IND. CODE § 23-2-1-5(b)(1)(B) (1976) ("a description of any *material* interest in any *material* transaction with the issuer") (emphasis added). Of course, the seller of securities which have been registered, but were not registered at the time of the sale, will not escape liability even if all material facts are disclosed because such sales still would violate the Indiana Securities Act. *Id.* § 23-2-1-3.

¹⁹In fact, the definition of "fraud" and similar terms is phrased in terms of "materiality." *Id.* § 23-2-1-1(d).

²⁰583 F.2d 542 (1st Cir. 1978).

²¹398 N.E.2d at 433.

Securities Act have discussed "material facts," none have specified or established any standard.²²

The court's reliance on *Holmes* is interesting. *Holmes*, unlike *Arnold*, was not brought under a state securities act based upon the Uniform Securities Act. *Holmes* was brought under section 10(b) of the Securities Exchange Act of 1934,²³ and Securities and Exchange Commission Rule 10b-5.²⁴ *S & F Supply Co. v. Hunter*²⁵ would have been appropriate authority in *Arnold*. In *Hunter* the Utah Supreme Court construed a provision similar to section 23-2-1-19(a)²⁶ and concluded that "materiality" is an objective standard and that a "material fact" is "something which a buyer or seller of ordinary intelligence and prudence would think to be of some importance in determining whether to buy or sell."²⁷

There is, of course, nothing amiss with using federal authority to establish the requisite standards for state securities law violations. It is particularly appropriate to use federal authority in construing a civil liability provision like section 23-2-1-19(a); section 23-2-1-19(a) is based on section 410(a)(2) of the Uniform Securities Act which is "almost identical with § 12(2) of the Securities Act of 1933."²⁸ It is irrelevant that *Holmes* was a section 10(b)²⁹ and rule 10b-5 case,³⁰ and not a section 12(2) case,³¹ because even *Hunter*³²

²²See *Rousseff v. Dean Witter & Co.*, 453 F. Supp. 774 (N.D. Ind. 1978); *B & T Distributions, Inc. v. Riehle*, 359 N.E.2d 622 (Ind. Ct. App.), *vacated*, 266 Ind. 646, 366 N.E.2d 178 (1977); *Theye v. Bates*, 166 Ind. App. 652, 337 N.E.2d 837 (1975); *Soft Water Utils., Inc. v. LeFevre*, 159 Ind. App. 529, 308 N.E.2d 395 (1974). *Cf. Menten v. Churchman*, 112 Ind. App. 309, 42 N.E.2d 426 (1942) (representation as to future earnings of the stock held to be vital inducement in the sale of options for the stock and therefore material).

²³15 U.S.C. § 78j(b) (1976).

²⁴17 C.F.R. § 240.10b-5 (1980).

²⁵527 P.2d 217 (Utah 1974).

²⁶IND. CODE § 23-2-1-19(a) (1976).

²⁷527 P.2d at 221. *Accord*, *Lane v. Midwest Bancshares Corp.*, 337 F. Supp. 1200 (E.D. Ark. 1972); *Allen v. Schauf*, 202 Kan. 348, 449 P.2d 1010 (1969). *See also* *Bradley v. Hullander*, 272 S.C. 6, 249 S.E.2d 486 (1978).

²⁸UNIFORM SECURITIES ACT (U.L.A.) § 410(a)(2) at 672 (Master Ed. 1978). For a comparison of section 12(2) of the Securities Act of 1933, 15 U.S.C. § 77 l(2) (1976), with equitable rescission, from which it was adapted, *see generally* III, IV LOSS, *supra* note 9, at 1699-705, 1708-21, 3831-42. Section 410(a)(2) of the Uniform Act, like IND. CODE § 23-2-1-12 (1976), the general fraud provision, applies even if the security is registered, exempted, or sold in violation of registration requirements. *See* UNIFORM SECURITIES ACT (U.L.A.) § 410(a)(2) (Master Ed. 1978).

²⁹See 15 U.S.C. § 78j(b) (1976).

³⁰See 17 C.F.R. § 240.106.5 (1980).

³¹15 U.S.C. § 77l(2) (1976).

³²527 P.2d at 221 n.10.

relied on *SEC v. Texas Gulf Sulphur Co.*,³³ the seminal rule 10b-5 decision, in positing the test of materiality. The *Arnold* court had no difficulty in determining that the omissions from the NGC prospectus were "material." These omissions were clearly facts that a reasonable investor would deem important in making an investment decision.³⁴

Because the NGC shares were sold by the corporation and not by Arnold as an individual, his liability depended on the scope of section 23-2-1-19(b).³⁵ This provision subjects five categories of persons to derivative liability for unlawful sales of securities.³⁶ Arnold argued that liability could be imposed only on persons who materially aided the unlawful sale. He contended that the phrase "who materially aids in the sale," which is part of the clause imposing liability on "employees" of sellers, also applies to and modifies the clause imposing derivative liability on "every partner, officer, or director of such a seller" for unlawful sales by the seller.

Although the argument is not specious, the court of appeals was clearly correct in rejecting it and holding that directors are liable under section 23-2-1-19(b)³⁷ regardless of whether they materially aid the transaction unless, of course, they can sustain their statutory defense that they did not and could not reasonably have knowledge of the facts on which liability was predicated. The court noted that

³³401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969) 404 U.S. 1005 (1971). Of course the fortunes of *Texas Gulf* have waned in recent years, but Judge Waterman, in writing for the majority, at one point stated that a "basic test of materiality . . . is whether a *reasonable* man would attach importance . . . in determining his choice of action in the transaction in question." 401 F.2d at 849 (emphasis in original) (quoting *List v. Fashion Park, Inc.*, 340 F.2d 457, 462 (2d Cir. 1965)).

The Supreme Court made it clear in *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438 (1976) that the test of materiality is a "would influence" and not a "might influence" test. In *TSC*, the Court stated that a fact is material

if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote. . . . Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered [sic] the "total mix" of information made available.

Id. at 449. *TSC* involved the proxy provisions of the Securities Exchange Act of 1934, but the test of materiality laid down in that case applies to all federal securities laws. See *Alton Box Bd. Co. v. Goldman, Sachs & Co.*, 560 F.2d 916, 920 (8th Cir. 1977).

³⁴398 N.E.2d at 433.

³⁵The text of IND. CODE § 23-2-1-19(b) (1971) (current version at IND. CODE § 23-2-1-19(b) (1976)). is set forth in note 2 *supra*.

³⁶IND. CODE § 23-2-1-19(b) (1976). The categories are: (1) every person who directly or indirectly controls a seller liable under *id.* § 23-2-1-19(a); (2) every partner, officer, or director of such a seller; (3) every person occupying a similar status or performing similar functions; (4) every employee of such a seller who materially aids in the sale; and (5) every broker-dealer or agent who materially aids in the sale.

³⁷*Id.* § 23-2-1-19(b).

from a grammatical and punctuation standpoint the provision imposes absolute liability on directors because of their status. If the legislature had intended to make only those directors liable who materially aided the transaction it would have been a simple matter to insert the "materially aids" phrase into the director clause.³⁸

Furthermore, the *Arnold* construction of section 23-2-1-19(b)³⁹ is logical considering the purpose of the Indiana Securities Act. The Act is intended to protect investors; this goal can best be achieved by subjecting those who control or manage the seller of securities to absolute liability. It is logical to hold those who control sellers, and thus presumably can prevent unlawful securities transactions, to a high standard to protect the investing public. It would be unreasonable, however, to hold those who are mere employees of the seller, or who are securities broker-dealers or agents, to the same high standard if they are not materially involved in the transaction because they are not in a position to control the activities of the seller.

Decisions from several other jurisdictions construing blue sky law provisions similar or identical to section 23-2-1-19(b) also have made absolute the liability of directors and officers of a corporation selling securities in violation of those acts. The *Arnold* court cited and relied on *Rzepka v. Farm Estates, Inc.*⁴⁰ and *Foelker v. Kwake*⁴¹ in support of this proposition, and *Moerman v. Zipco, Inc.*⁴² and *Mitchell v. Beard*⁴³ for the related proposition that employees, broker-dealers, and agents are liable only if they materially aid in the sale notwithstanding that no similar restriction applies to those in a control position.

The *Arnold* court also rejected *Arnold's* claim that he had established the "lack of knowledge" defense provided by section

³⁸398 N.E.2d at 433-34. The *Arnold* court does not point this out, but it is important to note that the phrase "who materially aids in the sale" appears twice in IND. CODE § 23-2-1-19(b) (1976): (1) with respect to employees of the seller; and (2) with respect to broker-dealers or agents. Thus, two of the five categories of persons subjected to liability under *id.* § 23-2-1-19(b) are qualified by a "materially aid" phrase. This is a clear indication that the legislature did not intend to qualify the three remaining categories.

³⁹IND. CODE § 23-2-1-19(b) (1976).

⁴⁰83 Mich. App. 702, 269 N.W.2d 270 (1978).

⁴¹279 Or. 379, 568 P.2d 1369 (1977). *Accord*, *Collins v. Fitzwater*, 277 Or. 401, 560 P.2d 1074 (1977); *Day v. Saunders*, 270 Or. 432, 528 P.2d 513 (1974); *Ludwig v. Mutual Real Estate Investors*, 18 Wash. App. 33, 567 P.2d 658 (1977).

⁴²302 F. Supp. 439 (E.D.N.Y. 1969).

⁴³256 Ark. 926, 513 S.W.2d 905 (1974). *Accord*, *Alton Box Bd. Co. v. Goldman, Sachs & Co.*, 560 F.2d 916 (8th Cir. 1977); *Rucker v. La-Co, Inc.*, 496 F.2d 850 (8th Cir. 1974); *Labenz v. Labenz*, 198 Neb. 548, 253 N.W.2d 855 (1977); *Cola v. Terzano*, 129 N.J. Super. 47, 322 A.2d 195 (1974), *aff'd sub nom.* *Cola v. Packer*, 156 N.J. Super. 77, 383 A.2d 460 (1977); *McClellan v. Sundholm*, 89 Wash. 2d 527, 574 P.2d 371 (1978).

23-2-1-19(b).⁴⁴ Arnold alleged that he had been misled by the assurances from NGC's president that all stock sales complied with the Indiana Securities Act.⁴⁵ However, the evidence strongly suggested that Arnold was aware of many of the transactions that were not adequately described in the NGC prospectus. In effect, Arnold was contending that although he knew of the facts, he did not know of their legal significance. In other words, he pleaded that he was "ignorant of the law."⁴⁶ The court relied on *Rzepka* and *Moerman* in holding that derivative liability is imposed on those who know the applicable facts without regard to their knowledge of the law.⁴⁷

This is a reasonable construction of the defense provided by section 23-2-1-19(b).⁴⁸ The defense is not phrased in terms of good faith but refers to actual or constructive knowledge of "*the existence of the facts by reason of which the liability is alleged to exist.*"⁴⁹ The essence of the defense is the reasonable care exercised by the defendant; although a director's sophistication and his reasonable reliance on information transmitted by an expert might be factors in determining his knowledge, "they are not the sole determinants for establishing his liability."⁵⁰

⁴⁴Under IND. CODE § 23-2-1-19(b) (1976) a person charged with derivative liability can escape liability if he "sustains the burden of proof that he did not know and in the exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist."

⁴⁵398 N.E.2d at 434-35.

⁴⁶*Id.* at 435.

⁴⁷The *Arnold* court, quoting *Moerman v. Zipco, Inc.*, 302 F. Supp. 439 (E.D.N.Y. 1969), stated:

Nothing persuades this court that Connecticut or the drafters of the Uniform Laws intended to do away with the common law rule that ignorance of the law is no defense. The Connecticut statute provides only that ignorance of the applicable facts, after the exercise of reasonable care, is a defense. There is no suggestion that defendant's knowledge of the law is a necessary element of a cause of action.

398 N.E.2d at 435 (quoting 302 F. Supp. at 450).

⁴⁸IND. CODE § 23-2-1-19(b) (1976).

⁴⁹*Id.* (emphasis added). The *Arnold* court correctly declined to read a good faith defense into the statute because the legislature had not. 398 N.E.2d at 435. See *Town of Schererville v. Vavrus*, 389 N.E.2d 346, 350 (Ind. Ct. App. 1979).

⁵⁰398 N.E.2d at 435. In effect the *Arnold* court is requiring directors and officers of corporations subject to the Indiana Securities Act to meet the same standard of care imposed by section 11(b) of the Securities Act of 1933, 15 U.S.C. § 77k(b) (1976), on directors and other signatories of registration statements filed with the SEC. See *Feit v. Leasco Data Processing Equip. Corp.*, 332 F. Supp. 544 (E.D.N.Y. 1971); *Escott v. BarChris Constr. Corp.*, 283 F. Supp. 643 (S.D.N.Y. 1968). See generally *Folk, Civil Liabilities Under the Federal Securities Acts: The BarChris Case*, 55 VA. L. REV. 1, 199 (1969); Comment, *Escott v. BarChris: How Much Diligence Is Due*, 17 U. KAN. L. REV. 651 (1969).

Arnold also correctly held that section 23-2-1-19(a)⁵¹ does not require a plaintiff to show reliance.⁵² The only burden imposed by the then applicable provision is that the plaintiff buyer not know "of the untruth or omission."⁵³ Although not cited, this construction is supported by *Forrestal Village, Inc. v. Graham*⁵⁴ which construed the comparable section of the District of Columbia Securities Act. Furthermore, reliance is not an element of a cause of action under section 12(2) of the Securities Act of 1933,⁵⁵ upon which the Indiana derivative liability section⁵⁶ is based.

Arnold also raised an unsuccessful statute of limitation defense. The Indiana Securities Act statute of limitations in effect at the time of the suit provided that an "[a]ction under this section shall be commenced within two [2] years after discovery by the person bringing the action of a violation of this act and not afterwards."⁵⁷ The

⁵¹IND. CODE § 23-2-1-19(a) (1971) (current version at IND. CODE § 23-1-2-19(a) (1976)).

⁵²398 N.E.2d at 435.

⁵³IND. CODE § 23-2-1-19(b) (1971) (current version at IND. CODE § 23-2-1-19(b) (1976)). The present provision requires that a plaintiff "not knowingly participate in the violation or . . . not have, at the time of the transaction, knowledge of the violation." *Id.* § 23-2-1-19(a).

⁵⁴551 F.2d 411 (D.C. Cir. 1977). Of course, it should be noted that the Utah Supreme Court in *S & F Supply Co. v. Hunter*, 527 P.2d 217, 221 (Utah 1974), observed that a state securities act could not

fairly be understood as meaning that a buyer can naively or blindly purchase stock without concern for the truth or reasonableness of representations made, [and] then if it later develops that it would serve his interest, assert a claim of falsity of a representation about which he previously had no concern, and upon which he had placed no reliance, as a basis for avoiding his contract. This is fairly deducible from the parenthetical clause in the statute quoted above (the buyer not knowing of the untruth or omission).

However, this does not seem to impose a reliance element so much as it imposes a semblance of a duty of care on the part of the plaintiff. *See also* *McGraw v. Matthaei*, 388 F. Supp. 84 (E.D. Mich. 1972); *Lane v. Midwest Bancshares Corp.*, 337 F. Supp. 1200 (E.D. Ark. 1972). *See generally* discussion of *B & T Distrib. Inc. v. Riehle*, 359 N.E.2d 622 (Ind. Ct. App. 1977), *rev'd*, 266 Ind. 646, 366 N.E.2d 178 (1977) in *Galanti, Business Associations, 1977 Survey of Recent Developments in Indiana Law*, 11 IND. L. REV. 27, 28-35 (1978) [hereinafter cited as *Galanti, 1977 Survey*].

⁵⁵*Sanders v. John Nuveen & Co.*, 619 F.2d 1222 (7th Cir. 1980). *See also* *Johns Hopkins Univ. v. Hutton*, 422 F.2d 1124 (4th Cir. 1970), *cert. denied*, 416 U.S. 916 (1974). *See generally* 3A H. BLOOMENTHAL, SECURITIES AND FEDERAL CORPORATE LAW §8.23 (1980 rev.); III LOSS, *supra* note 9, at 1645 n.83. Some causal connection must be shown, however, between the misleading communication and the sale. *Jackson v. Oppenheim*, 533 F.2d 826 (2d Cir. 1976). There is clearly such a connection when the misleading communication is in a prospectus.

⁵⁶IND. CODE § 23-2-1-19(a) (1976).

⁵⁷IND. CODE § 23-2-1-19(e) (1971) (current version at IND. CODE § 23-2-1-19(e) (1976)). The statute was amended in 1975 to increase the period to three years. *See generally* *Galanti, 1975 Survey, supra* note 2, at 63. *Cf. Rouseff v. Dean Witter & Co.*, 453 F. Supp. 774 (N.D. Ind. 1978) (applying the three year statute of limitations to an action brought subsequent to the enactment of the three year limitation).

court of appeals rejected his contention that the statute started running when a plaintiff "in the exercise of reasonable care should have discovered the violations."⁵⁸ Relying on the specific language of the Act, the court found that the Act does not intimate any reasonable diligence standard on the part of the plaintiff.⁵⁹

The court also held that although the class was not certified until April 9, 1974, the filing of the amended complaint in April, 1973 tolled the statute of limitations for all members of the class.⁶⁰ Furthermore, the court rejected Arnold's contention that each member of the class was obliged to prove that he discovered the violations within two years before the amended complaint was filed.⁶¹

At first glance it may seem harsh to impose substantial liability on a director who has been misled by the president of a corporation into believing that the legal requirements for the sale of securities have been satisfied.⁶² Arnold, however, can at least seek contribution from the remaining defendants: the last sentence of section 23-2-1-19(b) provides for "contribution as in cases of contract among the several persons so liable."⁶³ Thus, the liability imposed on Ar-

⁵⁸398 N.E.2d at 440.

⁵⁹*Id.* The rule argued for by Arnold does obtain under the Securities Act of 1933, § 13, 15 U.S.C. § 77m (1976). See *Johns Hopkins Univ. v. Hutton*, 422 F.2d 1124 (4th Cir. 1970), *cert. denied*, 416 U.S. 916 (1974). See generally III LOSS, *supra* note 9, at 1742-43.

⁶⁰398 N.E.2d at 439. In this respect, the court followed the position urged by Professor Moore. See 3B MOORE'S FEDERAL PRACTICE ¶ 23.50, at 23-434 (1980).

⁶¹398 N.E.2d at 440. The court recognized that a plaintiff might have to prove facts to prevent the running of the statute when a defendant raising the statute as an affirmative defense has gone forward with evidence that a claim is barred; however, the burden of persuasion still remains on the defendant asserting the bar. *Id.* When the Dirrims' suit was certified as a class action, it was treated as a certified class action from the day the amended complaint was filed. *Id.*

⁶²The Indiana General Corporation Act permits directors in satisfying their duty of care to the corporation to "rely on information, opinions, reports or statements . . . in each case prepared or presented by: (A) one (1) or more officers or employees of the corporation whom the director reasonably believes to be reliable and competent in the matter presented" IND. CODE § 23-1-2-11(a)(2) (Supp. 1980). This provision, however, relates to a director's general duty of care to a corporation and would not affect the express statutory liability imposed by the Act. *Id.* § 23-2-1-19(b) (1976). See generally discussion on the amendments to § 23-1-2-11(a) in Galanti, 1977 Survey, *supra* note 54, at 47-50.

Attorney-directors should take note that there is authority holding that a lay-director subject to derivative liability under a state securities act has a cause of action for legal malpractice against an attorney-director who was a corporation's legal counsel. The cause of action is based on the attorney-director negligently failing to advise the corporation as to the registration requirements and liability provisions of the securities act. *Collins v. Fitzwater*, 277 Or. 401, 560 P.2d 1074 (1977). Moreover, the *Collins* court held that the lay-director's claim against the attorney could be assigned to the purchasers of the unregistered securities. *Id.* at 408-09, 560 P.2d at 1078.

⁶³IND. CODE § 23-2-1-19(b) (1976). According to the Commissioners on Uniform

nold will theoretically be spread among all those responsible for the management, or more accurately the mismanagement, of NGC.⁶⁴

B. Limited Partnership Liability

*Plaza Realty Investors v. Bailey*⁶⁵ was a diversity action decided during the survey period by the Federal District Court for the Southern District of New York.⁶⁶ It is only the second reported decision applying the Indiana Uniform Limited Partnership Act.⁶⁷

The action was brought by Plaza against VIP Center, an Indiana limited partnership, as the maker of a promissory note, and Bailey, as the managing general partner of VIP Center. The court granted Plaza's unopposed motion for summary judgment against VIP Center⁶⁸ but dismissed the action against Bailey. The primary ground for dismissing the action against Bailey, a Florida resident who never personally appeared in New York, was that Bailey had insufficient contacts with New York to satisfy the due process clause of the United States Constitution⁶⁹ and to sustain personal jurisdiction under New York's long arm statute.⁷⁰ The court, however, did not content itself with dismissing the action on jurisdictional

Laws, this provision is intended to act as "a safeguard to avoid the common law rule which prohibits contribution among joint tort-feasors." UNIFORM SECURITIES ACT, 7A U.L.A. 672 (Master Ed. 1978). Arnold is not completely deserving of sympathy. In a companion case, *Arnold v. Dirrim*, 398 N.E.2d 442 (Ind. Ct. App. 1979), an appeal from an order in a proceedings supplemental action brought to collect the \$553,439.36 judgment against Arnold, the court of appeals upheld the trial court's finding that certain property transfers by Arnold to his wife, son, and a controlled corporation were fraudulent as to the plaintiffs.

⁶⁴In addition to the securities act issues, the defendant unsuccessfully raised numerous procedural issues which are beyond the scope of this survey article.

⁶⁵484 F. Supp. 335 (S.D.N.Y. 1979).

⁶⁶The suit originally was commenced in a New York state court but was removed to the federal court pursuant to 28 U.S.C. §§ 1441(a), 1446 (1976). 484 F. Supp. at 338.

⁶⁷IND. CODE §§ 23-4-2-1 to -31 (1976). The Indiana Act is based on the 1916 Uniform Limited Partnership Act and not the Revised Uniform Limited Partnership Act adopted by the Commissioners on Uniform Laws in 1976. REVISED UNIFORM LIMITED PARTNERSHIP ACT (U.L.A.) §§ 1101-1105 (Master Ed. Supp. 1980).

⁶⁸484 F. Supp. at 338.

⁶⁹U.S. CONST. amend. V.

⁷⁰N.Y. CIV. PRAC. LAW § 302 (Consol.).

Neither the fact that the note was payable in New York nor that telephone calls and other interstate telephonic communications were made across state lines established sufficient contacts with the state. Although transacting business through an agent in New York would satisfy the requirements, the evidence showed that the person who negotiated the real estate transaction in New York was not acting on Bailey's behalf. The court also found that Bailey had not ratified those acts merely by becoming VIP Center's managing general partner and receiving some benefits in the form of tax savings. 484 F. Supp. at 345-48.

grounds but also made findings of fact and conclusions of law supporting a dismissal on the merits.⁷¹

A threshold issue in *Bailey* was what law controlled. The court decided that Indiana law would apply. A major factor in this decision was that the note itself recited that Indiana law should govern and the conflict of laws rules of New York give great deference to the intent of the parties in choice of law questions.⁷² Furthermore, Indiana had numerous significant contacts with the transactions in question.⁷³ The same result probably would have been reached if New York law had been applied because that state has also adopted the Uniform Limited Partnership Act.⁷⁴ Furthermore, as the *Bailey* court observed, the case was one where "virtually all jurisdictions would be expected to follow general common law principles."⁷⁵ Thus, although the ruling on the merits in *Bailey* can be categorized as dictum, it is still significant because the Indiana Limited Partnership Act is based on the widely adopted Uniform Limited Partnership Act.⁷⁶

A brief recounting of the facts in *Bailey* is necessary to understand the court's conclusion that Bailey was not personally liable on the partnership's note even though he was the general partner. The normal rule is that the general partner of a limited partnership is personally liable for partnership debts.⁷⁷ VIP Center was organized in 1973 to develop a multi-purpose real estate complex on land previously conveyed to Plaza on a sale and leaseback basis by VIP Cen-

⁷¹The court undertook this seemingly unnecessary task to avoid duplication of judicial effort in the event that it was determined on appeal that the court had personal jurisdiction over Bailey. 484 F. Supp. at 348.

⁷²484 F. Supp. at 348-49. See *CBS, Inc. v. Tucker*, 412 F. Supp. 1222, 1226 n.5 (S.D.N.Y. 1976).

⁷³484 F. Supp. at 349. The note was made by an Indiana limited partnership; it was secured by Indiana real estate; and the documents in question were executed, delivered, and recorded in Indiana.

⁷⁴N. Y. PARTNERSHIP LAW §§ 90-119 (Consol.).

⁷⁵484 F. Supp. at 349 (quoting *Lee v. Joseph E. Seagram & Sons, Inc.*, 552 F.2d 447, 451 n.3 (2d Cir. 1977)).

⁷⁶Forty-seven states, the District of Columbia, and the Virgin Islands have limited partnership acts based on the 1916 Uniform Limited Partnership Act. 6A U.L.A. 99 (Supp. 1980).

⁷⁷A limited partnership must have a least one general partner, IND. CODE § 23-4-2-1 (1976), who is "subject to all the restrictions and liabilities of a partner in a partnership without limited partners." *Id.* § 23-4-2-9. See *Kitchell Corp. v. Hermansen*, 8 Ariz. App. 424, 446 P.2d 934 (1968); *Atlanta Warehouses, Inc. v. Housing Auth.*, 143 Ga. App. 588, 239 S.E.2d 387 (1977); *Cummings v. Nordmark*, 73 Wash. 2d 322, 438 P.2d 605 (1968). See also IND. CODE §§ 23-4-1-9, -15, -17, -18 (1976). See generally J. CRANE & A. BROMBERG, PARTNERSHIP § 26, at 150 (1968) [hereinafter cited as CRANE & BROMBERG]; H. REUSCHLEIN & W. GREGORY, HANDBOOK ON THE LAW OF AGENCY AND PARTNERSHIP § 264, at 436-37 (1979) [hereinafter cited as REUSCHLEIN & GREGORY].

ter's original limited partner.⁷⁸ VIP Center eventually became the owner of the improvements being constructed on the land and the lessee under the land lease with Plaza. Unfortunately, VIP Center ran out of money and defaulted on the land lease with the plaintiff and on a first mortgage on the real estate.⁷⁹

The original general partner sought new partners⁸⁰ who would advance the funds necessary to complete the project. He found one potential general partner who in turn interested defendant Bailey's parents (the "senior Baileys") in becoming limited partners. One of Bailey's law partners conducted negotiations on behalf of the senior Baileys. Although these proved unsuccessful, they led to direct negotiations between Plaza and the senior Baileys. These negotiations eventually culminated in the senior Baileys' agreeing, on December 27, 1974, to become limited partners in VIP Center.⁸¹

A major issue in *Plaza Realty* was whether Plaza intended to look only to the property as security on the promissory note or whether the partners were to be personally liable on the promissory note as well. A related issue was whether Bailey was involved with VIP Center on December 27, 1974. The court concluded that Bailey was not a general partner on that date because he did not agree to become the general partner until December 30. Moreover, he did not acquire partner status until the transaction was closed on December 31, 1974.⁸²

The timing of the closing was influenced by tax considerations,⁸³ and was somewhat complicated because the various parties in interest were located in three states.⁸⁴ The order in which the various documents were executed was critical to the ultimate outcome of the case. The promissory note in issue and other documents were

⁷⁸484 F. Supp. at 339.

⁷⁹Following the default, VIP Center's interest in the leasehold was assigned to Plaza which thereby became the owner of the improvements as well as the owner of the land. *Id.*

⁸⁰New partners could take advantage of the substantial tax losses available to the partnership. *Id.* at 339-40.

⁸¹*Id.* at 340-41.

⁸²*Id.* at 352. Plaza was unaware of Bailey's involvement in VIP Center until after the closing. *Id.* at 342. Bailey became the general partner in return for 1% of VIP Center's tax deduction for the year 1974. He also invested \$11,000 in the limited partnership. *Id.*

⁸³The transaction whereby Bailey and his parents invested in VIP Center had to be completed before noon on December 31, 1974, to permit them to take advantage of VIP Center's losses on their 1974 tax returns. *Id.* at 343.

⁸⁴The holder of the first mortgage was in New York; a trustee of Plaza, who was also a member of the law firm representing Plaza, and an Indiana attorney authorized to sign documents on behalf of Bailey were in Indiana; Bailey's law partner representing the interests of the Baileys was in Florida. *Id.* at 342-43.

signed by VIP Center's original general partner on December 30, 1974. None of these documents were exchanged, however, until the amendment to the limited partnership agreement required by the Indiana Limited Partnership Act⁸⁵ had been signed on December 31, 1974.⁸⁶ If Bailey was a general partner when the note was executed, then he would be personally liable for the entire obligation. If, however, he became a general partner *after* the note was executed, then he would be liable only to the extent of his interest in VIP Center property.⁸⁷

The court concluded that Bailey did not become VIP Center's managing general partner until an amended limited partnership certificate specifying his status as a general partner was filed as required by section 23-4-2-25(5) of the Indiana Limited Partnership Act.⁸⁸ The filing did not occur until after the note was delivered to Plaza. The court found that although Bailey agreed on December 30 to become the general partner and the amended limited partnership agreement specifically provided that it was "to be effective as of December 30, 1974,"⁸⁹ the filing of the amendment was the controlling factor.

The result in *Plaza Realty* absolving Bailey from liability seems to be correct. The evidence indicates that Plaza intended the real estate to be the security on the promissory note. The action against Bailey was presumably taken when Plaza realized that the security was inadequate or that holding Bailey personally liable was more convenient.⁹⁰

⁸⁵IND. CODE § 23-4-2-24(2)(d) (1976).

⁸⁶484 F. Supp. at 343.

⁸⁷IND. CODE § 23-4-1-6(2) (1976) provides that the Indiana Uniform Partnership Act, *id.* §§ 23-4-1-1 to -43, applies "to limited partnerships except in so far as the statutes relating to such partnerships are inconsistent herewith." See *Horn v. Builders Supply Co.*, 401 S.W.2d 143 (Tex. Civ. App. 1966). IND. CODE § 23-4-1-17 (1976) in turn provides: "A person admitted as a partner into an existing partnership is liable for all the obligations of the partnership arising before his admission as though he had been a partner when such obligations were incurred, *except that this liability shall be satisfied only out of partnership property.*" (emphasis added).

⁸⁸IND. CODE § 23-4-2-25(5) (1976).

⁸⁹484 F. Supp. at 343, 349. In so doing, the court summarily rejected Plaza's argument that IND. CODE § 23-4-1-17 (1976) did not apply because VIP Center was a shell, rather than a "existing partnership," and that in reality a new partnership was being formed. *Id.* at 349, 351. The court reasoned that although there was a change in VIP Center's management when Bailey became the managing general partner, the nature of the partnership business was unchanged. Furthermore, the court noted that both parties were aware that the continuity of the limited partnership was essential if the senior Baileys were to receive tax benefits from the transaction. It was to maintain this continuity that the original general partner was retained when the note to Plaza was executed. *Id.* at 351-52.

⁹⁰VIP Center's general partner who executed the note would have been personally liable, *see note 77 supra*, except that as part of the overall restructuring of the project,

There is little law on the question of whether an amendment pertaining to the membership of a limited partnership becomes effective when the agreement is reached or when the amended certificate is filed. The Indiana Limited Partnership Act provides that “[a] certificate is amended . . . when . . . [an appropriate writing] is filed for record in the office of the county recorder of the county where the principal place of business of the partnership is located.”⁹¹ This provision cannot mean that a general partner, upon agreeing to join the limited partnership, will never be bound on prior partnership obligations until the amended certificate is filed. The *Plaza Realty* court acknowledged this but concluded that its result was appropriate because the amended certificate was timely filed and Bailey had not acted on behalf of the partnership before it was filed.⁹² Furthermore, Plaza had not relied on Bailey’s participation in the venture when it decided to convey the real estate in question.⁹³

The one case the court found relevant to the issue of when an amendment to a limited partnership certificate becomes effective tangentially supported the court’s result. In *Harry David Zutz Insurance, Inc. v. H.M.S. Associates, Ltd.*,⁹⁴ the court upheld service of process on a limited partnership’s former general partner before an amended certificate was filed reflecting this change, even though the limited partnership had agreed that the former general partner no longer served in that capacity. The court’s decision in *Zutz* was appropriate. One of the purposes for filing a limited partnership certificate is to permit creditors to determine who is involved in the partnership.⁹⁵ This purpose would be defeated if a creditor could not rely on the information in a filed certificate.⁹⁶

Plaza Realty, however, was not the typical situation where courts have held persons acting for a “limited partnership” liable for partnership obligations after an agreement was signed but before a certificate was filed. The *Plaza Realty* court addressed the typical

Plaza granted him a general release from liability. 484 F. Supp. at 341 n.5. Plaza appears to have made a tactical mistake in releasing the original general partner from liability or in failing to specify that as part of the arrangement the incoming managing general partner would be personally liable.

⁹¹IND. CODE § 23-4-2-25(5) (1976).

⁹²484 F. Supp. at 351.

⁹³*Id.* The court observed that Plaza had received all the consideration it had bargained for: the senior Baileys joined the partnership and transferred over a million dollars in cash and notes to VIP Center. *Id.*

⁹⁴360 A.2d 160 (Del. Super. Ct. 1976).

⁹⁵*See* Hoefer v. Hall, 75 N.M. 751, 411 P.2d 230 (1965).

⁹⁶This was not a problem in *Plaza Realty*. Plaza did not appear to be particularly concerned who the general partner was, or was going to be, when the note was executed. 484 F. Supp. at 342. *Zutz* is therefore not controlling here since the parties in *Zutz* knew who was to be involved before the certificate was filed.

situation in its discussion of whether a limited partnership comes into existence at the time the partnership agreement is reached or at the time the certificate is filed.⁹⁷ The language of the 1916 version of the Uniform Limited Partnership Act is vague as to when existence commences, and the cases cited in *Plaza Realty* are generally concerned with whether a putative "limited partner" becomes a general partner when the certificate is either not filed or is not timely filed.⁹⁸ A person erroneously believing himself to be a limited partner can limit his liability even if the certificate is never filed.⁹⁹ The Revised Uniform Limited Partnership Act, approved in 1976, expressly provides that a limited partnership is formed at the time the certificate of limited partnership is filed.¹⁰⁰

⁹⁷484 F. Supp. at 350-51. IND. CODE § 23-4-2-2(1)(b) (1976) requires the filing of a limited partnership certificate containing certain specified information. For a model limited partnership certificate see REUSCHLEIN & GREGORY, *supra* note 77, at 579-81. For a model limited partnership agreement see *id.* at 573-78. Under IND. CODE § 23-4-2-2(2) (1976), a limited partnership is formed if there has been substantial compliance in good faith with the requirements of *id.* § 23-4-2-2(1).

⁹⁸*See, e.g.,* Peerless Mills, Inc. v. American Tel. & Tel. Co., 527 F.2d 445 (2d Cir. 1975); Ruth v. Crane, 392 F. Supp. 724 (E.D. Pa. 1975), *aff'd*, 564 F.2d 90 (3d Cir. 1977); Franklin v. Rigg, 143 Ga. App. 60, 237 S.E.2d 526 (1977). There is additional authority, including an Indiana decision, in support of the rule that failure to comply with the requirements of the Uniform Limited Partnership Act deprives the limited partner of limited liability status. *See, e.g.,* Filesi v. United States, 352 F.2d 339 (4th Cir. 1965); Bisno v. Hyde, 290 F.2d 560 (9th Cir. 1961), *cert. denied*, 368 U.S. 959 (1962); Tiburon Nat'l Bank v. Wagner, 265 Cal. App. 2d 868, 71 Cal. Rptr. 832 (1968); Arrow Petrol. Co. v. Ames, 128 Ind. App. 10, 142 N.E.2d 479 (1957); Hoefler v. Hall, 75 N.M. 751, 411 P.2d 230 (1965). *But see* United States v. Coson, 286 F.2d 453, 461-62 n.13 (9th Cir. 1961).

The Limited Partnership Act does not specify when the certificate must be filed, but it has been held that a reasonable time, determined by the circumstances of the particular case, is allowed for filing. *Stowe v. Merrilees*, 6 Cal. App. 2d 217, 44 P.2d 368 (1935). A late filing of a limited partnership certificate will not bar the creation of a limited partnership if the plaintiff has not been injured by the delay. *Franklin v. Rigg*, 143 Ga. App. 60, 237 S.E.2d 526 (1977).

⁹⁹IND. CODE § 23-4-2-11 (1976) provides that such a person is not bound on partnership obligations when upon "ascertaining the mistake he promptly renounces his interest in the profits of the business, or other compensation by way of income." *See, e.g.,* Giles v. Vette, 263 U.S. 553 (1924); Vidricksen v. Grover, 363 F.2d 372 (9th Cir. 1966); Graybar Elec. Co. v. Lowe, 11 Ariz. App. 116, 462 P.2d 413 (1969); Solomont v. Polk Dev. Co., 245 Cal. App. 2d 488, 54 Cal. Rptr. 22 (1966); Franklin v. Rigg, 143 Ga. App. 60, 237 S.E.2d 526 (1977); Gilman Paint & Varnish Co. v. Legum, 197 Md. 665, 80 A.2d 906 (1951); Rathke v. Griffith, 36 Wash. 2d 394, 218 P.2d 757 (1950).

¹⁰⁰REVISED UNIFORM LIMITED PARTNERSHIP ACT (U.L.A.) § 201(b) (Supp. 1980). The *Plaza Realty* court stated that the Revised Act has not been adopted by the states. 484 F. Supp. at 350. However, the Revised Act has been adopted in Connecticut, CONN. GEN. STAT. §§ 34-9 to -38 (1979), and Wyoming, WYO. STAT. §§ 17-14-201 to -1104 (Supp. 1980). Interestingly, the Revised Act does not expressly specify when an amendment to a certificate of limited partnership becomes effective. Section 202(a) provides that the certificate is amended by filing a certificate of amendment, and section 202(e) pro-

Because the VIP Center note was a preexisting partnership obligation when Bailey became the general partner, Bailey could only be personally liable beyond his interest in the venture if he expressly or impliedly adopted the obligation. The court cited *Lucas v. Coulter*,¹⁰¹ a pre-uniform act case, for this proposition. Interestingly, it did not cite *Wheat v. Hamilton*,¹⁰² which held that although an incoming partner is not liable for the prior partnership debts without his consent, very slight testimony will suffice to establish an assumption of those debts. Arguably, a case can be made that a person who becomes a general partner of a limited partnership in a major restructuring of the partnership and who is aware that a major new partnership obligation is being incurred would be liable for that obligation unless a contrary intent is clearly shown. Admittedly, this might not be the customary practice,¹⁰³ but the customary practice seems risky. A more advisable practice would be to state expressly in the relevant documents whether the incoming general partner is, or is not, to be held personally liable for the newly incurred obligation.

The *Plaza Realty* court, convinced that Plaza did not intend to hold Bailey personally liable and looking only to the real estate as security on the note, stated that if by law Bailey was liable on the note, the court would have reformed the note and inserted an exculpatory clause relieving him from personal liability.¹⁰⁴ On the authority of *Pearson v. Winfield*¹⁰⁵ the court concluded that there

vides that a person will not incur any liability because an amendment to a limited partnership certificate has not been filed if the amendment is filed within thirty days of the event. Therefore, the same result reached in *Plaza Realty* would presumably be reached in a jurisdiction that has adopted the Revised Act. See generally Hecker, *Revised Uniform Limited Partnership Act: Relationship of Firm and Its Members to Third Parties*, 27 KAN. L. REV. 1 (1978).

¹⁰¹104 Ind. 81, 3 N.E. 622 (1885). See generally CRANE & BROMBERG, *supra* note 77, § 88(b).

¹⁰²53 Ind. 256 (1876).

¹⁰³The court noted that the Indiana attorney who acted for the Baileys at the closing testified that the practice in Indiana with respect to this type of transaction was to execute the documents pertaining to the new obligation before the amendment to the certificate of limited partnership was executed and to record the amended certificate after all other documents were recorded. 484 F. Supp. at 350.

¹⁰⁴484 F. Supp. at 352, 354.

¹⁰⁵160 Ind. App. 613, 313 N.E.2d 95 (1974). The court distinguished *Adams v. Wheeler*, 122 Ind. 251, 23 N.E.2d 760 (1890), which reformed a deed wherein the drafters had inadvertently stated that Adams assumed a debt to Wheeler, because Plaza was seeking to hold Bailey liable by operation of law as a general partner of the VIP Center. 484 F. Supp. at 353. It did, however, accept *Adams* for the proposition that where the parties have agreed that only property should stand behind a promissory note, and not the personal assets of the purchaser, an instrument which does not reflect this intention should be reformed. Most of the testimony convinced the

was a mutual mistake which justified reforming a contract differing in its written form from what was actually agreed upon by the parties.

In this respect the court seems to be correct. The intent of the parties when the agreement was reached on December 27 was that Plaza's security would be in the real estate and would not include the personal assets of the former general partner or the unknown incoming general partner. The transaction was structured to accomplish that end; it would be unjust to give Plaza a second opportunity to hold the incoming general partner personally liable. Of course, a clause in the note exculpating the incoming general partner, as the *Plaza Realty* court would have accomplished by reformation, is a far more appropriate and safer procedure to follow.

C. Franchisor Liability

A third significant case during the survey period was the decision of the United States Court of Appeals for the Seventh Circuit in *Oberlin v. Marlin American Corp.*¹⁰⁶ *Oberlin* involved the impact of the Lanham Trademark Act¹⁰⁷ on Indiana agency law. The case arose from an unsuccessful marketing effort of a portable electronic telephone designed to fit within an attache case and to operate on the same frequencies available to mobile telephone installations. The manufacturer of the device¹⁰⁸ gave the defendant Marlin American Corporation the exclusive right to market the attache phone in all but a few states. The agreement obligated Marlin to try to establish a sales and marketing program in its assigned territory and provided that Marlin was an "independent contractor," and not an agent of the manufacturer.¹⁰⁹

Marlin established a nationwide franchising plan. As part of this plan a meeting was held in Indianapolis where a Marlin representative made a presentation praising the investment potential of an attache phone franchise. The plaintiff's husband became a franchise zone distributor of the telephones for central Indiana. When it became clear that the phone could not be successfully marketed in his territory,¹¹⁰ the plaintiff's husband brought a diversity action

court that the property was to be the only security on the note. The most favorable testimony that plaintiff could elicit was ambiguous. 484 F. Supp. at 354.

¹⁰⁶596 F.2d 1322 (7th Cir. 1979).

¹⁰⁷15 U.S.C. §§ 1051-1127 (1976 & Supp. III 1979).

¹⁰⁸The device was made by Melabs of California which was eventually acquired by defendant S.C.M. Corporation. 596 F. 2d at 1324.

¹⁰⁹*Id.*

¹¹⁰No numbers were available from Indiana Bell Telephone Company for these phones. *Id.* at 1235.

alleging that: (1) Marlin had fraudulently induced him to accept the distributorship, with the liability of defendants SCM and Melabs based on an alleged principal-agency relationship; (2) Marlin had breached the distributorship agreement; and (3) a conspiracy existed among the three defendants.¹¹¹

Marlin was dismissed from the suit before trial for lack of personal jurisdiction. Consequently the second count, in which only Marlin was charged as a defendant, was dismissed.¹¹² The district court directed a verdict for Melabs and SCM on the remaining counts after the plaintiff had presented her evidence.¹¹³ Thus, the issue on appeal was whether the plaintiff had presented sufficient evidence of an agency relationship between Marlin and the two defendants to go to the jury. The court of appeals affirmed the trial court and held that she had not presented sufficient evidence.¹¹⁴

The court initially observed that the provision in the agreement between Melabs and Marlin denominating Marlin as an independent contractor rather than an agent was of no significance.¹¹⁵ Although the court cited no authority, it is well settled that in determining whether a principal/agent or employer/independent contractor relationship exists depends on what the relationship is in fact and not what the parties call it.¹¹⁶ The key issue in determining the nature of the relationship is the extent of control the employer exercises over the putative agent. If the employer retains a substantial amount of control over the operation of the contracting party, the courts will determine that a principal/agent relationship exists. If, however, only minor control is retained, the employer/independent contractor

¹¹¹*Id.* William Oberlin died before the trial and his wife was substituted as plaintiff. *Id.*

¹¹²Plaintiff attempted to argue that Marlin's dismissal was error, but the court of appeals was satisfied that she had abandoned below any argument that the court had jurisdiction. Consequently, the issue was improperly raised on appeal. 596 F.2d at 1325 n.1. See *United States v. Sanchez*, 422 F.2d 1198, 1201-02 (2d Cir. 1970).

¹¹³596 F.2d at 1325-26. The plaintiff did not appeal from the directed verdict on the conspiracy count. *Id.* at 1325 n.2.

¹¹⁴The court, as is proper, noted that the correctness of the ruling was tested by considering only the operative facts favorable to the plaintiff, disregarding conflicting unfavorable testimony and drawing all inferences most strongly in her favor. *Id.* at 1326. See *Gunning v. Cooley*, 281 U.S. 90 (1930); *Hohmann v. Packard Instrument Co.*, 471 F.2d 815 (7th Cir. 1973); *Kish v. Norfolk & W. Ry.*, 426 F.2d 1132 (7th Cir. 1970). See generally 9 C. WRIGHT & A. MILLER, FEDERAL PRACTICE & PROCEDURE § 2536 (1971) [hereinafter cited as WRIGHT & MILLER].

¹¹⁵596 F.2d at 1326.

¹¹⁶See *Bartels v. Birmingham*, 332 U.S. 126 (1947); *Bond v. Harrel*, 13 Wis. 2d 369, 108 N.W.2d 552 (1961). See generally W. SEAVEY, HANDBOOK OF THE LAW OF AGENCY § 84C (1964) [hereinafter cited as SEAVEY].

status obtains. This status insulates the employer from liability to third parties except in certain circumstances.¹¹⁷

Typically, the issue of whether a party to an agreement is an independent contractor arises when an injured worker is attempting to hold the employer of his employer liable for a bodily injury.¹¹⁸ An independent contractor, however, also can be an agent of the employer and even bind him by unauthorized representations and contracts.¹¹⁹ This status, however, also depends on the degree of control exercised over the work done.¹²⁰ Thus, to a considerable extent the *Oberlin* court's distinction between the principal/agent and employer/independent contractor status was not accurate. The court should have been deciding in terms of agent or non-agent independent contractors. The ultimate issue, however, would be the same: did Melabs or SCM control Marlin's work.

Oberlin contended that the defendants had the requisite degree of control because the marketing agreement gave Melabs the right to approve all contract forms used by Marlin and required uniform terms, conditions, and prices to be offered to ultimate distributors.¹²¹ The court rightly rejected the contention that control of contract forms makes a distributor an agent.¹²² The control that defeats independent contractor status is control over the means by which the activities contracted for are to be accomplished and not control over mere incidental or peripheral matters. Melabs' control over forms and contracts was incidental to the main effort of Marlin's obligation to develop the franchise program.

Oberlin also argued that the provision in the marketing agreement that distributorships established by Marlin would be transferred to Melabs in the event of Marlin's default or bankruptcy

¹¹⁷See *Prest-O-Lite Co. v. Skeel*, 182 Ind. 593, 106 N.E. 365 (1914); *Curl v. Bethlehem Steel Corp.*, 390 N.E.2d 709 (Ind. Ct. App. 1979); *Cummings v. Hoosier Marine Properties, Inc.*, 363 N.E.2d 1266 (Ind. Ct. App. 1977); *Burkett v. Crulo Trucking Co.*, 355 N.E.2d 253 (Ind. Ct. App. 1976); *Hale v. Peabody Coal Co.*, 168 Ind. App. 336, 343 N.E.2d 316 (1976). See generally RESTATEMENT (SECOND) OF AGENCY §§ 2(3), 214, 220, 250, 251 (1958); RESTATEMENT (SECOND) OF TORTS §§ 409-429 (1965); REUSCHLEIN & GREGORY; *supra* note 77, § 51; SEAVEY, *supra* note 116, §§ 6B, 84C; W. SELL, AGENCY §§ 19, 95, at 86 (1975) [hereinafter cited as SELL].

¹¹⁸See note 117 *supra*.

¹¹⁹See generally SEAVEY, *supra* note 116, at 8; SELL, *supra* note 117, at 16.

¹²⁰See *Automatic Canteen Co. of America v. State Bd. of Equalization*, 238 Cal. App. 2d 372, 47 Cal. Rptr. 848 (1965); *Dumas v. Lloyd*, 6 Ill. App. 3d 1026, 286 N.E.2d 566 (1972); *Kablitz v. Hoelt*, 25 Wis. 2d 518, 131 N.W.2d 346 (1964).

¹²¹596 F.2d at 1326.

¹²²*Smith v. Cities Serv. Oil Co.*, 346 F.2d 349 (7th Cir. 1965); *Hancock v. Minneapolis-Moline, Inc.*, 482 P.2d 426 (Colo. Ct. App. 1971); *Burkhalter v. Ford Motor Co.*, 29 Ga. App. 592, 116 S.E. 333 (1923); *Coe v. Esau*, 377 P.2d 815 (Okla. 1963). See generally SEAVEY, *supra* note 116, § 84, at 145.

demonstrated the necessary control. This, too, was rejected because the provisions applied only in the extraordinary circumstances of bankruptcy or default.¹²³

The plaintiff's third major argument, although rejected by the court, was based on an intriguing theory. She argued that Melabs exercised control over Marlin's operations because it had approval rights over the use of the SCM trademark in advertising materials.¹²⁴ The Lanham Trademark Act requires the owner of a registered trademark to supervise a licensee's operations and subjects the owner to the loss of the trademark for failure to exercise such control.¹²⁵ The *Oberlin* court, however, held that this obligation is designed to ensure the integrity of the trademark and prevent its use to deceive the public as to the quality of the goods or services bearing the name.¹²⁶ The theory that the control a trademark owner must exercise over a licensee constitutes "control" for purposes of agency law is intriguing, but it is doubtful that Congress intended to make every trademark licensor a "principal" under state agency law when it adopted the Lanham Trademark Act.¹²⁷ Furthermore, the duty of supervision is narrowly limited to ensure the integrity of a registered trademark. This supervision, in and of itself, does not establish the degree of control over day-to-day operations necessary to support a conclusion that the licensor is exercising the control of a principal.¹²⁸

¹²³596 F.2d at 1326. See *Western Adjustment & Inspection Co. v. Gross Income Tax Div.*, 236 Ind. 639, 142 N.E.2d 630 (1957); *Gross Income Tax Div. v. Fort Pitt Bridge Works*, 227 Ind. 538, 86 N.E.2d 685 (1949).

¹²⁴596 F.2d at 1326-27.

¹²⁵15 U.S.C. §§ 1055, 1064(c), 1127 (1976). See generally 3, 4 CALLMAN, *THE LAW OF UNFAIR COMPETITION TRADEMARKS AND MONOPOLIES* §§ 78.2, 98.3(c) (3d ed. 1969).

¹²⁶596 F.2d at 1327. See *Sheila's Shine Prod. Inc. v. Sheila Shine, Inc.*, 486 F.2d 114 (5th Cir. 1973); *Turner v. HMH Publishing Co.*, 380 F.2d 224 (5th Cir.), *cert. denied*, 389 U.S. 1006 (1967); *Dawn Donut Co. v. Hart's Food Stores, Inc.*, 267 F.2d 358 (2d Cir. 1959).

¹²⁷A trademark license agreement without more does not create a fiduciary relationship between the licensor and licensee. *Noel Holding Corp. v. Carvel Dari-Freeze Stores, Inc.*, 140 N.Y.S.2d 640 (Sup. Ct. 1955).

¹²⁸See *Smith v. Cities Serv. Oil Co.*, 346 F.2d 349 (7th Cir. 1965); *McLaughlin v. Chicken Delight, Inc.*, 164 Conn. 317, 321 A.2d 456 (1973); *Arthur Murray, Inc. v. Smith*, 124 Ga. App. 51, 183 S.E.2d 66 (1971); *Coe v. Esau*, 377 P.2d 815 (Okla. 1963); *Murphy v. Holiday Inns, Inc.*, 216 Va. 490, 219 S.E.2d 874 (1975). There appears to be no Indiana authority directly on point, but *Oberlin* considered *Thompson Farms, Inc. v. Corno Feed Prod.*, 366 N.E.2d 3 (Ind. Ct. App. 1977), as bearing on the point. In *Thompson Farms*, the court held that a distributor was a mere conduit in a promotional scheme devised by the principal and hence was not liable where there was a direct contractual relationship between the principal and the ultimate purchaser of the product. *Id.* at 12-13.

The *Oberlin* court also rejected the contention that there was an "agency by estoppel" created by the use of the SCM trademark.¹²⁹ The court distinguished *Sheraton Corp. of America v. Kingsford Packing Co.*,¹³⁰ where the franchisor hotel corporation was estopped to deny the debts of the operator of a local Sheraton Inn. The estoppel in *Sheraton* was created when Sheraton knowingly permitted its trade name to be used in the course of business by the franchisee, a separate entity, without qualification or indication of separate ownership. In *Oberlin*, however, the defendants clearly maintained a distinction between themselves and Marlin. The plaintiff's reliance in *Sheraton* was reasonable and a result of the company's own business activities. This, however, was not true in *Oberlin*.¹³¹

D. Indiana Business Takeover Offers Act

The validity of the 1979 Indiana Business Takeover Offers Act¹³² was upheld by the United States District Court for the Southern District of Indiana in *City Investing Co. v. Simcox*.¹³³ The complaint was filed in connection with a tender offer by a City Investing subsidiary for the shares of Stokely-Van Camp Inc., an Indiana corporation with its principal place of business in Indianapolis. The complaint sought a declaratory judgment that the Takeover Offers Act was invalid and also sought injunctive relief barring the defendants from enforcing the Act against City Investing and its subsidiary.¹³⁴ The plaintiffs contended they were denied a fair hearing before an unbiased decision maker on their tender offer because of the alleged

¹²⁹596 F.2d at 1327 n.5.

¹³⁰162 Ind. App. 470, 319 N.E.2d 852 (1974).

¹³¹Various evidentiary points were raised in *Oberlin*, but with one exception these are beyond the scope of this survey. The exception was the court's statement that an agent's extrajudicial statement about a purported agency made while not in the presence of the alleged principal are inadmissible to establish the relationship in the absence of substantial independent evidence of the agency. 596 F.2d at 1328. See *Phenix Ins. Co. v. Jacobs*, 23 Ind. App. 509, 55 N.E. 778 (1899). This is a well settled rule, see generally *SELL*, *supra* note 117, at 26 n.16, that is essential to avoid subjecting enterprises to agency liability merely on the statement of a putative agent.

¹³²IND. CODE §§ 23-2-3.1-1 to -11 (Supp. 1980). The Act is discussed in Galanti, *Corporations, 1979 Survey of Recent Developments in Indiana Law*, 13 IND. L. REV. 133, 161-72 (1980) [hereinafter cited as Galanti, *1979 Survey*]. The earlier Indiana Business Takeover Act, IND. CODE §§ 23-2-3-1 to -12 (1976), was repealed by Act of Mar. 9, 1978, Pub. L. No. 2, § 2251, 1978 Ind. Acts 2 when the new Indiana Business Takeover Offers Act was adopted in 1979.

¹³³476 F. Supp. 112 (S.D. Ind. 1979).

¹³⁴*Id.* at 113. The defendants were the Indiana Secretary of State, the Indiana Securities Commissioner, the Indiana Attorney General, and Stokely-Van Camp, Inc. as an intervenor. The complaint also sought money damages in an unspecified amount, but that claim was stricken by the court. *Id.*

prejudgment of the case by the Indiana Securities Commissioner. In addition, the plaintiffs contended that the Takeover Offers Act violated the supremacy¹³⁵ and commerce clauses¹³⁶ of the United States Constitution both on its face and as applied to the plaintiffs.¹³⁷

The facts and chronology of the tactical moves that resulted in the reported decision are somewhat complex. The initial legal move occurred on May 22, 1979, when the Indiana Securities Commissioner, as authorized by the Takeover Offers Act,¹³⁸ issued an order directing the plaintiffs to cease and desist from purchasing Stokely shares until they had complied with the Act and the antifraud provisions of the Indiana Securities Act.¹³⁹ The order provided for a prompt hearing upon request of the plaintiffs. Simultaneously, the State of Indiana instituted an action for injunctive relief in the Marion County Superior Court and obtained a temporary restraining order barring the plaintiffs from making further purchases.¹⁴⁰ On June 1, 1979, the plaintiffs filed the instant suit in federal court and moved in the superior court to dissolve the temporary restraining order and the Commissioner's cease and desist order and to dismiss the state's complaint. Following an evidentiary hearing on June 4, 1979, the superior court denied the plaintiff's motion and also denied the state's motion for a preliminary injunction.¹⁴¹ Prior to the June 15, 1979 hearing ordered by the Securities Commissioner to consider the merits of his May 22 cease and desist order, the plaintiffs, as the defendants in the superior court proceeding, filed an answer and counterclaim demanding an injunction against being penalized for failure to comply with "the unconstitutional provisions of the Takeover Act."¹⁴²

Following his hearing, the Securities Commissioner issued an order on June 19, 1979, wherein he determined that the plaintiffs had intentionally disseminated false and misleading statements regarding their intentions in violation of the antifraud provision of

¹³⁵U.S. CONST. art. VI, cl. 2.

¹³⁶*Id.* art. I, §8, cl. 3.

¹³⁷476 F. Supp. at 113-14. The claim of unconstitutionality as applied to the plaintiffs was withdrawn in open court. *Id.* at 114.

¹³⁸IND. CODE § 23-2-3.1-10(a) (Supp. 1980).

¹³⁹*Id.* § 23-2-1-12 (1976).

¹⁴⁰476 F. Supp. at 114. This action is authorized by IND. CODE § 23-2-3.1-10(a) (Supp. 1980).

¹⁴¹476 F. Supp. at 114.

¹⁴²*Id.* The claim was still pending when *City Investing* was decided. On emergency application to the superior court, the plaintiffs requested the June 15, 1979 hearing be prohibited. On June 14, 1979, the superior court set aside the Securities Commissioner's cease and desist order on the ground that a hearing was required before the order could be issued, but the court refused to prohibit the scheduled hearing. *Id.*

the Securities Act and that their conduct constituted a takeover offer as defined in the Takeover Offers Act.¹⁴³ The order prohibited the plaintiffs from proceeding with the tender offer and from further acquisition of Stokely shares until they were in compliance.¹⁴⁴

The plaintiffs did not prevail in the federal suit. In denying the requested relief, the *City Investing* court concluded that: (1) the Securities Commissioner was not biased or prejudiced against the plaintiffs and had conducted himself in accordance with Indiana law; (2) the defendants had neither harassed nor attempted to harass the plaintiffs; (3) the plaintiffs would not be injured if the equitable relief demanded was not granted because City Investing's subsidiary had announced that it was discontinuing purchasing Stokely shares due to the recessionary nature of the economy; (4) although the court had both personal and subject matter jurisdiction, the plaintiffs had failed to prove all legal elements of the complaint; (5) the plaintiffs had failed to prove irreparable injury because the appeal to the Indiana Court of Appeals from the Securities Commissioner's cease and desist order was an adequate remedy at law; and (6) the plaintiffs had not been deprived of due process of law.¹⁴⁵

The court held, in effect, that it did not have to resolve the constitutional challenge to the Takeover Offers Act because the plaintiffs, having announced that they were not making a tender offer for the Stokely shares, lacked standing as an aggrieved offeror.¹⁴⁶ It also held that there was a question of state law regarding whether the acquisition of shares was a "takeover offer" within the meaning of the Act. Because resolution of this issue could dispose of the case, it was unnecessary for the court to decide the constitutionality of the Act.¹⁴⁷

As is often the case, immediately after determining that it did not have to resolve the plaintiffs' challenge, the court went to the "merits" and upheld the validity of the Takeover Offers Act. It opined that the Act did not conflict with the rights of an offeror to make a

¹⁴³IND. CODE § 23-2-3.1-1(i) (Supp. 1980).

¹⁴⁴476 F. Supp. at 115. On July 6, 1979, plaintiffs filed a notice of appeal of this order with the Indiana Court of Appeals pursuant to IND. CODE § 23-2-3.1-11 (Supp. 1980).

¹⁴⁵476 F. Supp. at 115.

¹⁴⁶*Id.*

¹⁴⁷*Id.* at 116. The court was in effect applying the abstention doctrine of *Railroad Comm'n v. Pullman Co.*, 312 U.S. 496 (1941). See generally C. WRIGHT, HANDBOOK OF THE LAW OF FEDERAL COURTS § 52, at 218-21 (3d ed. 1976); 17 C. WRIGHT, A. MILLER & E. COOPER, FEDERAL PRACTICE & PROCEDURE § 4241 (1978). The court also concluded that the injunctive relief being sought by plaintiffs was barred by the federal Anti-Injunction Act, 28 U.S.C. § 2283 (1976). 476 F. Supp. at 116.

tender offer under section 14(d) of the Williams Act.¹⁴⁸ The court found that the Act was not an obstacle to the goals of the federal act and thus was not preempted under the supremacy clause simply because the Takeover Offers Act's provisions differed from those chosen by Congress. The court also concluded that the Takeover Offers Act did not impose an impermissible burden on interstate commerce; section 28(a) of the Securities and Exchange Act of 1934¹⁴⁹ purportedly gives states the right to regulate such transactions. The court, however, only reached conclusions and did not discuss to any great extent¹⁵⁰ the grounds for invalidating state takeover statutes raised in *Great Western United Corp. v. Kidwell*.¹⁵¹ Thus, *City Investing* should not be considered to be the final and definitive statement on the validity of the Indiana Takeover Offers Act.

Furthermore, even if the Takeover Offers Act did not conflict with the Williams Act when *City Investing* was decided, it is important to note that since then the SEC has adopted tender offer rules that could well create a fatal conflict for state takeover statutes under the supremacy clause.¹⁵² For example, SEC rule 14d-2(b)¹⁵³ requires that a tender offer commence within five business days of its public announcement. Sections 6 and 8 of the Takeover Offers Act¹⁵⁴ effectively delay the commencement of a tender offer for fifteen business days after a statement concerning the offer is filed with the Securities Commissioner and the target company.¹⁵⁵ To deem the filing of the tender offer statement with the Commissioner and the target company to *not* be a "public announcement" would do violence to the common understanding of the term, particularly if the offeror simultaneously communicates with the target company shareholders. Consequently, the Takeover Offers Act would seem to conflict with federal law and must fall under the supremacy clause.¹⁵⁶

¹⁴⁸15 U.S.C. § 78n(d) (1976).

¹⁴⁹*Id.* § 78bb(a).

¹⁵⁰476 F. Supp. at 116.

¹⁵¹439 F. Supp. 420 (N.D. Tex. 1977), *aff'd*, 577 F.2d 1256 (5th Cir. 1978), *rev'd on other grounds, sub. nom.* *Leroy v. Great Western United Corp.*, 443 U.S. 173 (1979). See generally Galanti, 1979 *Survey*, *supra* note 132, at 161-72; Galanti, 1977 *Survey*, *supra* note 54, at 46-47; Galanti, 1975 *Survey*, *supra* note 2, at 52-59.

¹⁵²U.S. CONST. art. VI, cl. 2.

¹⁵³17 C.F.R. § 240.14d-2(b) (1980) (effective January 7, 1980). See also 17 C.F.R. § 240.14d-1 to e-2 (1980). The SEC takes the position in SEC Release No. 34-16384 (Nov. 29, 1979) that Rule 14d-2(b) will preempt state takeover acts. 44 Fed. Reg. 70326, 70330 (1979).

¹⁵⁴IND. CODE § 23-2-3.1-6, -8 (Supp. 1980).

¹⁵⁵*Id.* §§ 23-2-3.1-3, -5.

¹⁵⁶U.S. CONST. art. VI, cl.2. Of course, this would not include tender offers that are not subject to the Williams Act, but there are relatively few offers of such a nature. The Williams Act applies to tender offers for equity securities registered pursuant to

A conflict like this has been raised in other jurisdictions. In *GM Sub Corp. v. Liggett Group, Inc.*,¹⁵⁷ the court accorded a presumption of validity to rule 14d-2 and concluded it might conflict with the Delaware takeover act¹⁵⁸ requirement that an announcement of a tender offer be made 20 days before the offer becomes effective. The Delaware Supreme Court concluded that the offeror might not be able to comply with both the Williams Act and the state statute and that it was improper for the lower court to restrain the offeror from complying with the Williams Act.¹⁵⁹ It did, however, remand to give the target company an opportunity to show that compliance with SEC rule 14d-2 and the state statute was possible and to attack the validity of the federal rule.¹⁶⁰

In *Eure v. Grand Metropolitan Ltd.*,¹⁶¹ a North Carolina court ruled that the provision of the North Carolina Takeover Act¹⁶² setting a thirty-day period for the commencement of a tender offer was unenforceable because it directly conflicted with the five-day period of rule 14d-2(b). The court held that this conflict made compliance with both regulations a "physical impossibility."¹⁶³ Although *Eure* might not stand for the proposition that state regulation of tender offers is completely prohibited, if the delay feature of state takeover acts is unenforceable, then the rest of the regulations are probably irrelevant.

section 12 of the Securities Exchange Act of 1934, 15 U.S.C. § 78(l) (1976), which includes corporations with assets exceeding \$1,000,000 and 500 shareholders. *Id.* § 78(l)(g)(1).

IND. CODE § 23-2-3.1-6 (Supp. 1980) permits a takeover offer to "be made" less than fifteen business days after the statement is filed with the Securities Commissioner if he so orders. This provision, however, is subject to *id.* § 23-2-3.1-8 which prohibits the purchase of or payment for shares for fifteen business days after the offer is made.

¹⁵⁷415 A.2d 473 (Del. 1980).

¹⁵⁸DEL. CODE ANN. tit. 8, § 203 (Supp. 1980).

¹⁵⁹More accurately the court concluded that a temporary restraining order was not an abuse of discretion but that interim injunctive relief should not be continued. 415 A.2d at 477. In *Wylain, Inc. v. TRE Corp.*, 412 A.2d 338 (Del. Ch. 1980) the court held that the Delaware Act was not preempted by the Williams Act, but *Wylain* was decided before *GM Sub*. See also *Strode v. Esmark, Inc.*, [Current] FED. SEC. L. REP. (CCH) ¶ 97,538 (Franklin Cir. Ct., (Ky.) May 13, 1980).

¹⁶⁰415 A.2d at 480. Because the jurisdiction granted in section 27 to enforce the Securities Exchange Act of 1934 is exclusively federal, 15 U.S.C. § 78aa (1976), there would seem to be some doubt as to whether a state court could pass on the validity of the SEC rule. See, e.g., *American Distilling Co. v. Brown*, 295 N.Y. 36, 64 N.E.2d 347 (1945). Cf. *Eure v. Grand Metropolitan Ltd.*, [1979-1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶97,383, at 97, 529 (N.C. Super. April 18, 1980) (court declared state statute preempted by rule 14d-2(b)).

¹⁶¹[1979-1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶97,383, at 97,529 (N.C. Super. April 18, 1980).

¹⁶²N.C. GEN. STAT. § 78B-4(a) (Supp. 1977).

¹⁶³[1979-1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶97,383, at 97,529.

The court in *City Investing*, however, might have been justified in refusing the injunctive relief sought by the plaintiffs. In *Telvest, Inc. v. Bradshaw*,¹⁶⁴ the United States Court of Appeals for the Fourth Circuit held that a district court erred in temporarily enjoining the enforcement of the Virginia takeover act before deciding the constitutional challenge on the merits. Although the court of appeals imagined potential conflicts that could not be reconciled, it concluded that the trial court had not adequately considered whether the Virginia act and the Williams Act could be reconciled.¹⁶⁵

The *Telvest* court did not decide whether the Virginia statute imposed an impermissible burden on interstate commerce and merely noted that such a burden would have to be shown by *Televest*.¹⁶⁶ Even if state statutes can be reconciled with the Williams Act and rule 14d-2, and conceivably the Indiana Takeover Offers Act can be reconciled if the Securities Commissioner permits a tender offer to become effective within five days of a public announcement while barring any share acquisition for a fifteen-day period, the commerce clause issue might well be the death knell of state takeover statutes. The Supreme Court in *Great Western* did recognize that states can still regulate securities transactions.¹⁶⁷ However, the offeror in the *GM Sub* and *Eure* cases had to file disclosure documents in Delaware, New Jersey, and North Carolina and was subject to litigation in the same three states. It is difficult to see how three states can have a legitimate interest¹⁶⁸ in regulating a tender offer. If they do, then it is difficult to see how they can avoid conflicting regulations which might discourage the making of tender offers, thereby placing an undue burden upon interstate commerce.

E. Consideration for Shares

The validity of a corporation's issuance of shares to a majority shareholder was upheld in *Garbe v. Excel Mold, Inc.*¹⁶⁹ In *Garbe*, two

¹⁶⁴618 F.2d 1029 (4th Cir. 1980).

¹⁶⁵*Id.* at 1035. The *Telvest* court did not consider whether there was any conflict between the Virginia statute and rule 14d-2 but noted that the SEC concluded in SEC Release No. 34-16384 (Nov. 29, 1979), 44 Fed. Reg. 70326, that its regulations conflicted with state statutes even if the Williams Act itself was not in conflict. 618 F.2d at 1036 n.10.

¹⁶⁶*Id.*

¹⁶⁷443 U.S. a 182. The Court pointed out that section 28(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78bb(a) (1976), was intended to save state blue sky laws from exemption. 443 U.S. at 182 n.13. A state blue sky law might prevent an issuer from selling securities in that particular state, but none others, whereas a state takeover act can completely stymie a tender offer in all states.

¹⁶⁸See *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970); *Huron Portland Cement Co. v. City of Detroit*, 362 U.S. 440 (1960).

¹⁶⁹397 N.E.2d 296 (Ind. Ct. App. 1979).

minority shareholders challenged the issuance of shares by Excel Mold in substantial part for the difference between the fair market value of equipment conveyed to Excel Mold by the majority shareholder and the allocated value of the equipment in a purchase agreement whereby the majority shareholder acquired the equipment.¹⁷⁰

The value allocated to the machinery equipment of the business in the agreement was \$244,200, although it was appraised by an independent third party expert at a value of \$395,800. Thus the equipment was worth \$151,600 more than the amount specified in the agreement.¹⁷¹ The plaintiff shareholders, who were employees of the firm, were invited to make cash investments in Excel Mold. The majority shareholder invested \$5,000 in cash and assigned the equipment to Excel Mold as consideration for his shares. He received approximately 80 percent of the issued shares.¹⁷²

The minority shareholders sued, alleging that there was no consideration for the majority shareholder's shares other than the \$5,000. The only issue on appeal was whether it was contrary to law for the majority shareholder to receive shares in exchange for the difference between the fair market value of equipment conveyed to Excel Mold and the value as specified in the original purchase agreement.¹⁷³

The *Garbe* court acknowledged that a shareholder of a closely held corporation stands in a fiduciary relationship to other shareholders and consequently must deal fairly, honestly, and openly with the corporation and the other shareholders.¹⁷⁴ It did, however,

¹⁷⁰*Id.* at 297. The majority shareholder had acquired the business from its former parent corporation. The majority shareholder, the vice president and general manager of the subsidiary, had acquired all the assets with borrowed funds. *Id.*

¹⁷¹*Id.*

¹⁷²*Id.* at 298.

¹⁷³*Id.* The court noted in passing that no gain or loss was recognized for tax purposes on the transfer of the assets to the corporation under section 351 of the Internal Revenue Code. I.R.C. § 351. The basis of the equipment to the corporation would be the allocated value rather than the fair market value. Because of the incumbrances, the shareholder's basis for his shares was zero. Upon selling the stock, however, he would be taxed on the full benefit of his bargain. 397 N.E.2d 298 n.2.

¹⁷⁴The court cited *Motor Dispatch, Inc. v. Buggie*, 379 N.E.2d 543 (Ind. Ct. App. 1978) and *Hartung v. Architects Hartung/Odle/Burke, Inc.*, 157 Ind. App. 546, 301 N.E.2d 240 (1973), discussed in Galanti, *Business Associations, 1974 Survey of Recent Developments in Indiana Law*, 8 IND. L. REV. 24, 42-46 (1974). See generally Conway, *The New York Fiduciary Concept in Incorporated Partnerships and Joint Ventures*, 30 FORDHAM L. REV. 297 (1961); Hornstein, *Judicial Tolerance of the Incorporated Partnership*, 18 L. & CONTEMP. PROB. 435 (1953). See also *Cressy v. Shannon Continental Corp.*, 378 N.E.2d 941 (Ind. Ct. App. 1978) discussed in Galanti, *1979 Survey, supra* note 132, at 150-55.

recognize that the Indiana General Corporation Act controls matters for which it specifically provides.¹⁷⁵ In *Garbe* the relevant provision was section 23-1-2-6(e) which provides in pertinent part, with respect to the consideration for corporate shares, that

[t]he consideration for the issuance of shares of any corporation may be paid, in whole or in part, in money, *in other property, tangible or intangible . . .* In the *absence of actual fraud in the transaction, the judgment of the board of directors as to the value of such property . . . shall be conclusive.*¹⁷⁶

The equipment was clearly "property" valued by the board of directors of Excel Mold at \$151,600. Because the record showed that plaintiffs at least acquiesced in the method of valuing the majority shareholder's shares, which was outlined to them at a board of directors meeting,¹⁷⁷ a conclusion of "fraud" was not inevitable. Such a conclusion would be necessary before the negative judgment could be reversed on appeal.¹⁷⁸ A transaction like the one in *Garbe* could be fraudulent if the property is drastically overvalued. The *Garbe* transaction, however, could not be labeled fraudulent because the appraisal establishing the value of the equipment, which was not questioned at trial, was by a disinterested expert.¹⁷⁹

F. Liability of Agents

The peril of an agent who commits a tort while acting on behalf of his principal was clearly demonstrated in *Howard Dodge & Sons, Inc. v. Finn*.¹⁸⁰ The court of appeals in *Finn* reversed a judgment in favor of Richard Dodge, the individual defendant, who was secretary-treasurer of Dodge & Sons and remanded with instructions to enter judgment in favor of the plaintiff Finn. The action was for converting heating and air conditioning equipment furnished by Dodge & Sons as a subcontractor of Millikan. Dodge & Sons was building a new home for Finn and had delivered the equipment to the

¹⁷⁵*Accord*, *Somers v. AAA Temporary Servs., Inc.*, 5 Ill. App. 3d 931, 284 N.E.2d 462 (1972).

¹⁷⁶IND. CODE § 23-1-2-6(e) (1976) (emphasis added). For a discussion of what consideration is proper for the issuance of shares *see generally* H. HENN, HANDBOOK OF THE LAW OF CORPORATIONS §§ 167-168 (2d ed. 1970) [hereinafter cited as HENN]; 1 G. HORNSTEIN, CORPORATION LAW & PRACTICE § 247 (1959) [hereinafter cited as HORNSTEIN].

¹⁷⁷397 N.E.2d at 298-99.

¹⁷⁸*See* *Umbreit v. Chester B. Stem, Inc.*, 373 N.E.2d 1116 (Ind. Ct. App. 1978). *See generally* BAGNI, GIDDINGS & STROUD, *supra* note 8, § 107.

¹⁷⁹397 N.E.2d at 299.

¹⁸⁰391 N.E.2d 638 (Ind. Ct. App. 1979).

construction site and had billed Millikan for the materials and labor involved. Millikan in turn billed Finn, who paid Millikan in full for the specific items furnished by Dodge & Sons.¹⁸¹

Eventually Finn terminated the construction contract with Millikan because of various defaults. Millikan then notified Dodge & Sons of the termination. Subsequently, Richard Dodge and some employees removed some of the equipment from the job site.¹⁸² Finn filed an action for replevin after demanding a return of the equipment and a supplemental complaint for conversion when Dodge & Sons was unable to comply. The trial court entered judgment for Finn against Dodge & Sons but refused to enter judgment against Richard Dodge. Both Dodge & Sons and Finn appealed from this judgment.

The court of appeals had no difficulty affirming the judgment against Dodge & Sons.¹⁸³ The court concluded that the evidence established that Dodge & Sons had appropriated the personal property of Finn to its own use and benefit "in exclusion and defiance of the owner's rights and under an inconsistent claim of title" and was therefore guilty of tortious conversion.¹⁸⁴ Finn asserted his immediate unqualified right to possession and superior claim to title on two theories: that the equipment had become fixtures to his real property, and that under the Indiana Uniform Commercial Code¹⁸⁵ he owned the heating and air conditioning equipment.

The court did not decide the first contention but concluded that title to the equipment had passed to Finn, despite any reservation of a security interest, when Dodge & Sons completed the physical delivery.¹⁸⁶ Thus, title passed to Millikan when the equipment was delivered to the construction site and in turn passed to Finn when he paid Millikan's bills specifically listing the equipment.¹⁸⁷ Consequently, the judgment against Dodge & Sons was proper because it converted Finn's property when it reasserted dominion over the equipment.

The court, however, reversed as to Richard Dodge and reaffirmed the long standing doctrine that an agent is personally liable for a tor-

¹⁸¹*Id.* at 640.

¹⁸²*Id.*

¹⁸³The court noted that if there was sufficient evidence to support the trial court's judgment on any theory the judgment would not be disturbed. *Id.* See *Devine v. Grace Constr. & Supply Co.*, 243 Ind. 98, 181 N.E.2d 862 (1962); *Dubreuil v. Pinnick*, 383 N.E.2d 420 (Ind. Ct. App. 1978); *Utica Mut. Ins. Co. v. Ueding*, 370 N.E.2d 373 (Ind. Ct. App. 1977); *Ertle v. Radio Corp. of America*, 354 N.E.2d 783 (Ind. Ct. App. 1976).

¹⁸⁴391 N.E.2d at 640-41. See *Yoder Feed Serv. v. Allied Pullets, Inc.*, 359 N.E.2d 602 (Ind. Ct. App. 1977); *Sikora v. Barney*, 138 Ind. App. 686, 207 N.E.2d 846 (1965).

¹⁸⁵IND. CODE § 26-1-1-101 to -10-106 (1976).

¹⁸⁶391 N.E.2d at 641. See IND. CODE § 26-1-2-401 (1976).

¹⁸⁷391 N.E.2d at 641.

tious act performed on behalf of his principal. All relevant Indiana authority on this point is from the nineteenth century.¹⁸⁸ The court relied on the Indiana Supreme Court decision in *Berghoff v. McDonald*¹⁸⁹ holding an agent personally liable for wrongfully detaining the goods of another for his principal.

Finn and *Berghoff* are in accord with the general rule as to an agent's personal liability. As Professor Seavey points out: "An agent who innocently deals with the possession of chattels of another on account of the principal may be liable to one who is entitled to them."¹⁹⁰ Seavey also observes that many of the cases where an agent is held liable for converting property of another "involved the repossession of property to which the principal believes he is entitled."¹⁹¹ This is exactly the *Finn* situation.

The authority cited by Seavey, for the most part, is also from the nineteenth century,¹⁹² but the relatively recent New Hampshire Supreme Court decision in *New England Box Co. v. Gilbert*¹⁹³ also supports this proposition. In *Gilbert* the court held the officers of a corporation who disposed of chattels, which the plaintiff had purchased from the corporation, personally liable as agents.

Whether Richard Dodge was acting in good faith in repossessing the equipment is irrelevant. As Dean Sell points out, an agent's liability for conversion does not depend on bad faith, and even if he mistakenly believes the chattels are his principal's "it is immaterial how reasonable that belief may be."¹⁹⁴ Sell does point out that the agent's acts must seriously interfere with the rights of the third party and that the agent's mere possession of the goods is insufficient to constitute a conversion.¹⁹⁵ It is apparent in *Finn* that Dodge was actively involved in the repossession of the heating and air conditioning equipment.

It is not clear if reversing the judgment in favor of Richard Dodge was of great economic significance because of Dodge & Sons' liability. It might be significant, however, if there was some question as to the financial health of the corporation. Of course, if Finn

¹⁸⁸*Berghoff v. McDonald*, 87 Ind. 549 (1882); *McNaughton v. City of Elkhart*, 85 Ind. 384 (1882); *Blue v. Briggs*, 12 Ind. App. 105, 39 N.E. 885 (1895); *Block v. Haseltine*, 3 Ind. App. 491, 29 N.E. 937 (1892).

¹⁸⁹87 Ind. 549 (1882).

¹⁹⁰SEAVEY, *supra* note 116, § 131.

¹⁹¹*Id.*

¹⁹²*See Haas & Howell v. Godby*, 33 Ga. App. 218, 125 S.E. 897 (1924); *Warder-Bushnell & Glessner Co. v. Harris*, 81 Iowa 153, 46 N.W. 859 (1890); *McPartland v. Read*, 93 Mass. (11 Allen) 231 (1865).

¹⁹³100 N.H. 257, 123 A.2d 833 (1956). *See generally* HENN, *supra* note 164, § 230; 1 HORNSTEIN, *supra* note 176, § 518.

¹⁹⁴*See* SELL, *supra* note 117, § 198, at 178.

¹⁹⁵*Id.*

enforced the judgment against Dodge, Dodge would not be entitled to contribution from the corporation because of the general rule, as unwise as it may be, of prohibiting contribution among joint tortfeasors.¹⁹⁶ In addition, an agent, forced to pay damages because of his torts, cannot recover these damages from his principal.¹⁹⁷

G. Corporate Officer's Authority

The court in *Morton v. E-Z Rake, Inc.*¹⁹⁸ affirmed a judgment that the vice president and secretary of E-Z Rake had rightfully discharged plaintiffs for cause but remanded with instructions that one of the plaintiffs was entitled to ten percent of defendant's net profits pursuant to his employment agreement.¹⁹⁹ The plaintiffs alleged that the officer was without authority to discharge them because discharging employees was a nondelegable duty of E-Z Rake's board of directors. The basis of this argument was the "corporate norm" as reflected in E-Z Rake's bylaws which vested the management and control of the business in the board of directors.²⁰⁰ The plaintiffs also sought support for their allegations from the provision of the Indiana General Corporation Act specifying the authority of officers and agents of a corporation.²⁰¹

The *Morton* court, however, recognized that although a board of directors is charged with control and management of a corporation's business, it may authorize officers to act on behalf of the corporation by resolution, course of dealing, acquiescence, or ratification.²⁰² The court did not clearly resolve whether the vice president had the

¹⁹⁶See generally RESTATEMENT (SECOND) OF TORTS § 886A(3) (1979); W. PROSSER, HANDBOOK OF THE LAW OF TORTS § 50 (4th ed. 1971).

¹⁹⁷Duncan Hill, L.R. 8 Ex. 242 (1873). See generally REUSCHLEIN & GREGORY, *supra* note 77, § 89(B), at 147; SEAVEY, *supra* note 116, § 168(M). In fact, the principal may have a cause of action for indemnity against the agent. W. PROSSER, *supra* note 196, § 51.

¹⁹⁸397 N.E.2d 609 (Ind. Ct. App. 1979).

¹⁹⁹*Id.* at 610, 614.

²⁰⁰*Id.* at 612. Prior to 1977, section 23-1-2-11(a) of the Indiana General Corporation Act specifically provided: "The business of every corporation shall be managed by a board of directors." IND. CODE § 23-1-2-11(a) (1976). In 1977 the relevant language was amended to read: "All corporate powers shall be exercised by or under the authority of, and the business and affairs of a corporation shall be managed under the direction of, a board of directors except as may be otherwise provided in this article or the articles of incorporation." *Id.* § 23-1-2-11(a)(1) (Supp. 1980). This amendment, which was patterned on the Model Business Corporation Act, 1 ABA-ALI MODEL BUS. CORP. ACT ANN. § 35 (2d ed. 1971), is discussed in Galanti, *1977 Survey*, *supra* note 54, at 47-50.

²⁰¹IND. CODE § 23-1-2-13 (1976).

²⁰²397 N.E.2d at 617. See *Crowe v. Gary State Bank*, 123 F.2d 513, 516 (7th Cir. 1941). See generally HENN, *supra* note 176, §§ 223-227; 1 HORNSTEIN, *supra* note 176, § 513.

authority to fire the plaintiffs because the directors had ratified the vice president's actions. They did so indirectly by confirming at a board meeting the two individuals who had been appointed to succeed the plaintiffs. The plaintiffs were given the opportunity to attend this meeting at the company's expense.²⁰³

One of the plaintiffs was entitled to a share of E-Z Rake's profits. If E-Z Rake intended the ten percent profit increment as just a bonus to which the plaintiff was not entitled as a matter of right, then the agreement was inartfully drawn.²⁰⁴ Any construction of the agreement would be favorable to the plaintiff because the agreement was prepared by the defendant's attorney.²⁰⁵ The court recognized that the incremental payment loosely could be termed a "bonus or incentive plan," but it was satisfied that the payment was as much a part of the plaintiff's regular compensation as his fixed monthly salary. Even if the employee was fired for cause during the fiscal year, there were no grounds for reforming the agreement to provide for denying the increment because the agreement did not provide for, nor anticipate, the termination of employment.²⁰⁶ As the court noted, "Had E-Z Rake intended to limit the profit-sharing portion of Paligraf's compensation in the manner it now presents, the necessary provision could have easily been placed in the contract."²⁰⁷

The other plaintiff did not fare as well because he was not wrongfully discharged. He did not have an employment contract; consequently, his employment was terminable at will. He claimed, however, that he was entitled to vacation and severance pay because of one instance where a salesman upon discharge had received a sum of money which the *plaintiff* characterized as "severance pay." E-Z Rake presented evidence that the payment was for commissions due on sales. Although the plaintiff had six weeks unused vacation time, he did not present any evidence that

²⁰³397 N.E.2d at 612-13. See *State ex rel. Guaranty Bldg. & Loan Co. v. Wiley*, 100 Ind. App. 438, 196 N.E. 153 (1935). The court refused to disturb the conclusion that the plaintiffs were fired for cause because evidence showed they were discharged for refusing to obey a direct order given by E-Z Rake's vice president and secretary. 397 N.E.2d at 613.

²⁰⁴See *Walling v. Plymouth Mfg. Corp.*, 139 F.2d 178 (7th Cir. 1943), *cert. denied*, 322 U.S. 741 (1944). The court appears to have confused the plaintiffs in discussing this issue, or at least used the name of the wrong plaintiff. 397 N.E.2d at 613.

²⁰⁵See *Colonial Mortgage Co. v. Windmiller*, 376 N.E.2d 529, 531-32 (Ind. Ct. App. 1978); *Mandle v. Owens*, 164 Ind. App. 607, 613, 330 N.E.2d 362, 366 (1975).

²⁰⁶See *Flynn v. Koppers Co.*, 567 F.2d 741 (7th Cir. 1977).

²⁰⁷397 N.E.2d at 614. The plaintiff was appealing from a negative judgment, but reversal was proper because the trial court's construction and interpretation of the employment contract was clearly contrary to the only correct interpretation that could be drawn from the evidence. *Id.* See generally BAGNI, GIDDINGS & STROUD, *supra* note 8, § 102.

vacation time could be accrued and payment made upon termination of employment.²⁰⁸ The evidence on these issues was in conflict; therefore, the *Morton* court rightfully refused to disturb the trial court's judgment.

H. Partnership Status

An intriguing argument *against* partnership liability was raised and rejected in *Endsley v. Game-Show Placements, Ltd.*²⁰⁹ *Endsley* affirmed a judgment against the defendant *Endsley* for a partnership debt to Game-Show. *Endsley* argued that section 23-4-1-7(4) of the Indiana Uniform Partnership Act which provides "receipt by a person of a share of the profits of a business is prima facie evidence that he is a partner in the business"²¹⁰ requires the *actual* receipt of money as profits before the inference of partnership can arise. The court rejected this narrow construction of the statute by noting that the language refers to the receipt of a "share" of the profits and not to the receipt of the profits.²¹¹

Although the word "share" does not by itself determine legislative intent, the court is clearly correct. The key in determining the existence of a partnership is the intention, deducible from the acts of the parties, to do something which in law constitutes a partnership.²¹² Thus, the essential element of section 23-4-1-7(4)²¹³ of the Partnership Act is the parties' intent regarding the division of profits that hopefully will result from the endeavor. To construe this section otherwise would produce the anomolous result that a statute imposing liability on partners would not apply to business ventures that fail at the outset.²¹⁴

Furthermore, section 23-4-1-7(4) only establishes that receiving a share of the profits is prima facie evidence that a person is a part-

²⁰⁸397 N.E.2d at 614.

²⁰⁹401 N.E.2d 768 (Ind. Ct. App. 1980).

²¹⁰IND. CODE § 23-4-1-7(4) (1976). This provision is identical to the UNIFORM PARTNERSHIP ACT (U.L.A.) § 7. The Indiana statute defines a partnership as "an association of two or more persons to carry on as co-owners a business for profit." IND. CODE § 23-4-1-6 (1976). See generally CRANE & BROMBERG, *supra* note 77, §§ 12-14.

²¹¹401 N.E.2d at 770.

²¹²See *Breinig v. Sparrow*, 39 Ind. App. 455, 80 N.E. 37 (1907); *Breinig v. Sparrow*, 39 Ind. App. 702, 80 N.E. 40 (1907).

²¹³IND. CODE § 23-4-1-7(4) (1976).

²¹⁴401 N.E.2d at 770. *Endsley* also argued that Game-Show must prove that he agreed to share losses as well as profits. *Id.* This argument was summarily dismissed. The general rule, in the absence of agreement to the contrary, is that partners share losses in the same proportion as they share profits. See *Kopka v. Yockey*, 76 Ind. App. 218, 131 N.E. 828 (1921). See *Trifunovic v. Marich*, 343 N.E.2d 825 (Ind. Ct. App. 1976). See generally CRANE & BROMBERG, *supra* note 77, § 14e.

ner; it specifically provides that the inference of partnership “shall [not] be drawn if such profits were received”²¹⁵ for certain enumerated purposes. The court concluded that the record established Endsley was to receive a share of the profits, and that he had not rebutted the inference of partnership by showing his share was to be received as one of the excepted types of payment.²¹⁶ Although Endsley was not actively involved in the day-to-day operations of the enterprise, as was the case in *Puzich v. Pappas*,²¹⁷ the evidence showed that he in fact had acted on behalf of the partnership.²¹⁸ The court acknowledged that there was conflicting testimony but refused to reverse the trial court because the evidence did not lead solely to the conclusion that Endsley was not a partner.²¹⁹

Finally, the court rejected Endsley’s contention that the trial court had used a *present* business relationship between Endsley and his co-entrepreneur to find a partnership existed at the time of the Game-Show contract. Using a present relationship is not a proper ground for determining that a partnership existed previously. The trial court in *Endsley*, however, could not have done so because the present relationship was corporate.²²⁰

²¹⁵IND. CODE § 23-4-1-7(4) (1976). The presumption is not to be drawn where profits are received in payment:

- (a) as a debt by instalment or otherwise,
- (b) as wages of an employee or rent to a landlord,
- (c) as an annuity to a widow or representative of a deceased partner,
- (d) as interest on a loan though the amount of payment vary with the profits of the business,
- (e) as the consideration for the sale of good will of a business or other property by instalments or otherwise.

Id. See *Huteson v. United States*, 67 F.2d 731 (7th Cir. 1933), *cert. denied*, 292 U.S. 627 (1934). See generally CRANE & BROMBERG, *supra* note 77, § 14A; REUSCHLEIN & GREGORY, *supra* note 77, § 178.

²¹⁶401 N.E.2d at 770.

²¹⁷161 Ind. App. 191, 314 N.E.2d 795 (1974), *discussed in Galanti, 1975 Survey, supra* note 2, at 44-46.

²¹⁸401 N.E.2d at 771. Apparently he borrowed capital for the enterprise and in the loan agreement stated that the business was a partnership and that the interest on the loan “will be computed on the basis of partnership return prepared and filed on behalf of [the partnership].” *Id.*

Game-Show did not argue that Endsley was a partner by estoppel under IND. CODE § 23-4-1-16 (1976). Instead, Game-Show used the loan agreement as an admission in documentary evidence to show a pattern of partnership activities. 401 N.E.2d at 771 n.3. Endsley apparently had admitted in an action upon that note that he was involved in the operation of the enterprise. *Id.* at 771.

²¹⁹401 N.E.2d at 771-72.

²²⁰*Id.* at 772. The court also concluded that damages were properly determined and that Endsley had not sufficiently established that the damages had been mitigated. *Id.* at 773. See *Jones v. Abriani*, 169 Ind. App. 556, 350 N.E.2d 635 (1976); *Hirsch v. Merchants Nat’l Bank*, 166 Ind. App. 497, 336 N.E.2d 833 (1975).

I. Special Charter Corporation

A decision that warrants at least a passing reference is *Union Insurance Co. v. State ex rel. Indiana Department of Insurance*.²²¹ In *Union* the court reaffirmed the doctrine that although the legislature can regulate the conduct and relations of special charter corporations,²²² the prohibition against such corporations in the 1851 Indiana Constitution²²³ invalidated legislative attempts to give Union's predecessors perpetual existence by amending the original charter.²²⁴ The court found that increasing Union's duration from fifty years to perpetuity was tantamount to *creating* a new corporation, and therefore was repugnant to the constitution.²²⁵

The court also rejected Union's arguments that its contract with the state had been "impaired." The court stated that when Union's license, in other words the fifty year duration, expired, so did its special privilege.²²⁶ Equally unsuccessful was the argument that previous litigation on the issue of Union's legitimate existence acted as *res judicata* to bar the present challenge.²²⁷ Consequently, Union was no longer a valid special charter insurance company and was therefore subject to regulation by the Indiana Department of Insurance.²²⁸

J. Statutory Developments

The most significant statutory enactment during the survey period was section 2 of Public Law Number 160²²⁹ which amended section 23-1-2-18 of the Indiana General Corporation Act.²³⁰ Prior to the amendment, section 23-1-2-18 permitted only a corporation with 500 or more shareholders to lend funds to officers or directors for purposes of purchasing its shares or to sell shares to officers or directors on credit. The amendment eliminated the size requirement.

²²¹401 N.E.2d 1372 (Ind. Ct. App. 1980).

²²²*City of Indianapolis v. Navin*, 151 Ind. 139, 147-48, 47 N.E. 525, 527 (1898).

²²³IND. CONST. art. XI, § 13.

²²⁴*In re Bank of Commerce*, 153 Ind. 460, 53 N.E. 950, 55 N.E. 224 (1899), *appeal dismissed*, 189 U.S. 505 (1903).

²²⁵401 N.E.2d at 1377.

²²⁶*In re Bank of Commerce*, 153 Ind. 460, 53 N.E. 950, 55 N.E. 224 (1899), *appeal dismissed*, 189 U.S. 505 (1903).

²²⁷401 N.E.2d at 1377-80.

²²⁸IND. CODE § 27-1-3-19 (1976).

²²⁹Act of Sept. 1, 1980, Pub. L. No. 160, § 2, 1980 Ind. Acts 1494. Section 1 of Pub. L. No. 160 amended IND. CODE § 23-1-2-4 (1976) to require that the corporate name of all Indiana professional corporations include "Corporation," "Incorporated," "Professional Services Corporation," "Professional Corporation," or an abbreviation thereof.

²³⁰IND. CODE § 23-1-2-18 (Supp. 1980).

The section now permits such loans or credit sales to officers or directors of any size Indiana corporation.

To a degree, the amended provision reflects the common trend toward lessening statutory restraints on activities of corporate management to the possible detriment of shareholders.²³¹ It does not, however, go nearly as far in this direction as section 47 of the Model Business Corporation Act²³² which permits loans or credit assistance to any employee, including directors, if the "board of directors decides that such loan or assistance may benefit the corporation."²³³ The Model Act almost gives the board carte blanche in lending corporate money to officers or directors.

Presumably the legislature intended to assist officers and directors of small closely held corporations by eliminating the numerical requirement. Assuming this was the intent, it is not certain if it will be effective. Such loans or credit sales are permitted only where the unpaid balance of loans and credit sales "made pursuant to this section does not and will not thereby exceed five per cent (5%) of the then current market value of [the corporation's] outstanding shares, or if such shares have no regularly quoted market value, five per cent (5%) of the net assets of the corporation."²³⁴ The proviso is clearly worded in the aggregate; consequently, unless the corporation is fairly substantial, the amount of money it can lend or the number of shares it can sell on credit to any one person would be relatively small.

Section 23-1-2-18 also requires that the loan or sale be made pursuant to a plan approved by a majority of the shareholders of the corporation and a majority of the shareholders of the class of shares affected.²³⁵ Of course, if a closely held corporation wishes to make such loans or credit sales, the chances of any objection to shareholder approval are probably minimal. The importance of compliance with this requirement, however, cannot be over emphasized. Loans or credit sales under section 23-1-2-18 are excepted from the proscription of section 23-1-10-2(e) of the General Corporation Act.²³⁶ Section 23-1-10-2(e) makes directors who vote for or assent to loans to officers or directors jointly and severally liable to the corporation

²³¹The restriction forbidding loans to corporate officers and directors is to protect the corporation, its shareholders and creditors. *Stadium Realty Corp. v. Dill*, 233 Ind. 378, 119 N.E.2d 893 (1954). See generally Eisenberg, *The Model Business Corporation Act and the Model Business Corporation Act Annotated*, 29 BUS. LAW. 1407 (1974).

²³²1 ABA-ALI MODEL BUS. CORP. ACT ANN. § 47 (2d ed. 1971).

²³³*Id.* § 47 at 950.

²³⁴IND. CODE § 23-1-2-18 (Supp. 1980).

²³⁵*Id.* The provision bars the corporation from delivering the share certificates until the loan is repaid or the last installment payment on the credit sale is made. *Id.*

²³⁶*Id.* § 23-1-10-2(e).

for the amount of the loan until it is repaid. Consequently, a loan or sale which does not comply with section 23-1-2-18 could result in personal liability on the part of the directors who voted for it.²³⁷

The only other noteworthy legislation in the business area was Public Law Number 186²³⁸ which amended sections 7, 17, and 23 of the Indiana Uniform Disposition of Unclaimed Property Act.²³⁹ The amendments provide that a business association²⁴⁰ issuing securities is deemed to be the holder of those securities for purposes of the Unclaimed Property Act when they have been abandoned.²⁴¹ The amendments also relieve the issuer of liability when such securities are delivered to the Attorney General's Unclaimed Property Division of the Indiana Attorney General's office pursuant to the Act.²⁴² In addition, the amendments change the manner in which abandoned securities may be disposed of by the attorney general and require him to dispose of such abandoned securities within one year after the date on which they are presumed to be abandoned.²⁴³

²³⁷See *Stadium Realty Corp. v. Dill*, 233 Ind. 378, 119 N.E.2d 893 (1954). Good faith, and even ignorance of the law, on the part of the directors would not be a defense. *Maclary v. Pleasant Hills, Inc.*, 35 Del. Ch. 39, 109 A.2d 830 (1954).

²³⁸Act of Feb. 27, 1980, Pub. L. No. 186, §§ 1-3, 1980 Ind. Acts 1602.

²³⁹IND. CODE §§ 32-9-1-7, -17, -23 (Supp. 1980). The Indiana Uniform Disposition of Unclaimed Property Act, *id.* §§ 32-9-1-1 to -45 (1976 & Supp. 1980), is perhaps a misnomer. It is a "substantial adoption" of the major provisions of the Revised 1966 Uniform Disposition of Unclaimed Property Act, but "it contains numerous variations, omissions and additional matter." 8 U.L.A. 76 (Master Ed. 1972). The changes effected by Pub. L. No. 186 are not reflected in the Uniform Act.

²⁴⁰A business association "means any corporation, including both for profit and not-for-profit corporations, joint stock company, business trust, partnership, eleemosynary organization or cooperative association and every other association or organization of two (2) or more individuals." IND. CODE § 32-9-1-3(c) (1976).

²⁴¹*Id.* § 32-9-1-7(3) (Supp. 1980).

²⁴²*Id.* § 32-9-1-17.

²⁴³*Id.* § 32-9-1-23.