

## V. CORPORATIONS

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## A. Shareholder Actions—Necessary Parties

Procedural problems and necessary parties in shareholder actions involving corporations in receivership were the issues resolved by the Indiana Supreme Court in *Sacks v. American Fletcher National Bank & Trust Co.*<sup>1</sup> The suit arose out of a financing agreement between JJS Co., an Indiana corporation, and the American Fletcher National Bank and Trust Company. The loan was personally guaranteed by plaintiff-appellant Sacks, one of the three shareholders of JJS Co., and defendant-appellee Blue, another shareholder. AFNB refused to renew the original loan or to extend additional credit when the loan remained unpaid at maturity. Rather, it brought suit in the Superior Court of Marion County to foreclose the security interests it held on the loan and for the appointment of a receiver. After his petition to the superior court for leave to sue in another forum was denied, Sacks brought the instant suit in Marion County Circuit Court. His second amended complaint asserted a shareholder derivative suit charging Blue and AFNB with misrepresentation, deceit, and breach of fiduciary obligations.<sup>2</sup> Sacks' principal assertion was that he had been assured that AFNB would provide continual financing for the corporate venture. Appellees filed motions to dismiss pursuant to Trial Rule 12(B)(7) and argued that the receiver, an indispensable party, had not properly been made a party to the suit since leave of the receivership court had been denied. The appellees' motions to dismiss were sustained, and Sacks appealed. The judgment was affirmed in part, reversed in part, and remanded with instructions.

Appellant contended that (1) the receiver was not an indispensable party under Trial Rule 19 and (2) even if the derivative action was properly dismissed for failure to join an indispensable party, the entire action should not have been dismissed because appellant also had a personal action against the appellees.<sup>3</sup> The supreme court accepted appellees' contention that there was a

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<sup>1</sup>279 N.E.2d 807 (Ind. 1972). Justice Hunter wrote the opinion. Justice DeBruler did not participate.

<sup>2</sup>*Id.* at 809.

<sup>3</sup>*Id.* at 810.

failure to join an indispensable party according to Trial Rule 19 when the receivership court denied Sacks leave to sue. The holding was premised on the well-established principle that the corporation is not merely a proper party to a derivative suit but an essential, indispensable party. The failure to make the corporation a party destroys the shareholder's cause of action and deprives the court of jurisdiction.<sup>4</sup> The supreme court emphasized that one of the reasons mandating joinder of the corporation was that it must be a party to receive the fruits of any recovery by the plaintiff.<sup>5</sup> There is, of course, a second major reason for the principle in that the corporation must be bound by the judgment in a derivative action and not be free to institute its own subsequent suit against the same defendants for the same alleged misdeeds.<sup>6</sup> The corporation is, in reality, the real party plaintiff in the suit, but enters the litigation as a nominal party defendant.<sup>7</sup>

The application of the principle in the *Sacks* case was complicated by the receivership of JJS Co. The supreme court ruled that under such circumstances the receiver, as the representative of the corporation, was the necessary party. No Indiana authority was cited for the proposition, but it does comport with the general rule obtaining in other jurisdictions. However, the determination that the receiver was a necessary party did not

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<sup>4</sup>IND. R. TR. P. 19(B). See *Carter v. Ford Plate Glass Co.*, 85 Ind. 180 (1882); 13 W. FLETCHER, PRIVATE CORPORATION § 5997, at 456 (perm. repl. ed. 1970) [hereinafter cited as FLETCHER]; H. HENN, LAW OF CORPORATIONS § 369 (1970) [hereinafter cited as HENN]; N. LATTIN, CORPORATIONS § 106, at 425-26 (2d ed. 1971) [hereinafter cited as LATTIN]. The courts do recognize an exception to this rule when a corporation's existence has been completely terminated prior to the commencement of the action. *Weinert v. Kinkel*, 296 N.Y. 151, 71 N.E.2d 445 (1947); HENN § 369, at 777; LATTIN § 106, at 425-26. Lattin points out that the rule requiring joinder can cause injustice when the real party defendants are in a jurisdiction in which the corporation itself cannot be personally served.

<sup>5</sup>13 FLETCHER § 5997, at 456. See also HENN § 369, at 777; LATTIN § 106, at 425-26.

<sup>6</sup>*Philipbar v. Derby*, 85 F.2d 27 (2d Cir. 1936); *Turner v. United Mineral Lands Corp.*, 308 Mass. 531, 33 N.E.2d 282 (1941); *Dean v. Kellogg*, 294 Mich. 200, 292 N.W. 704 (1940); 13 FLETCHER § 5998; HENN § 369, at 777; LATTIN § 106, at 426.

<sup>7</sup>13 FLETCHER § 5997; HENN §§ 364-67; LATTIN § 106, at 425. Indiana Rule of Trial Procedure 23.1 establishes the conditions precedent to a shareholder derivative action. The Trial Rule parallels Federal Rule of Civil Procedure 23.1 except that the shareholder demand requirement has been eliminated. See generally 13 FLETCHER § 6008; 2 W. HARVEY, INDIANA PRACTICE 365-89 (1970) [hereinafter cited as HARVEY]; HENN §§ 364-66; LATTIN § 105.

resolve the issue entirely since it was further complicated by the receivership court's denial of Sacks' petition for leave to sue the receiver in another court.<sup>8</sup>

The supreme court resolved this point, albeit with some degree of confusion, by essentially advising Sacks that he was in the wrong court and that the derivative action should have been brought in the receivership court itself.<sup>9</sup> The starting point for the supreme court was the doctrine that leave to sue a receiver must be obtained from the receivership court as a condition precedent to the action.<sup>10</sup> Justice Hunter then qualified this statement by noting that "this [the failure to obtain leave] alone is not sufficient to sustain a motion to dismiss. One must also determine whether it is feasible to join the necessary party."<sup>11</sup> Since leave to sue had been denied, it was clear that it was impossible to join the receiver as a party to the circuit court proceeding.

Although there are later cases, the leave issue, at least in recent years, apparently has not been a significant problem in Indiana. The most recent decision is *Malott v. State ex rel. Board of Commissioners*,<sup>12</sup> decided in 1902. The *Malott* decision held that a receiver cannot be sued without leave of the appointing court and the effect of the failure to obtain permission to sue the receiver vitiates jurisdiction. Thus, Indiana may be classified as adhering to the majority rule that although leave to sue is generally required, failure to secure permission to sue a receiver appointed by a state court does not affect the jurisdiction of the court in which suit is brought, when the suit is brought in the receivership court or when the receiver was appointed by a court of the United States.<sup>13</sup> The controlling authority, *Curtis v. Mauger*,<sup>14</sup> stated that

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<sup>8</sup>See e.g., *Coyle v. Skirvin*, 124 F.2d 934 (10th Cir.), cert. denied, 316 U.S. 673 (1942); 13 FLETCHER § 5999; HENN § 369, at 777.

<sup>9</sup>279 N.E.2d at 811.

<sup>10</sup>See *Malott v. State ex rel. Board of Comm'rs*, 158 Ind. 678, 64 N.E. 458 (1902); *Keen v. Breckenridge*, 96 Ind. 69 (1884). See also *Fields v. Fidelity Gen. Ins. Co.*, 454 F.2d 682 (7th Cir. 1971); Annot., 29 A.L.R. 1460 (1924).

<sup>11</sup>279 N.E.2d at 811. See 2 HARVEY 262-65.

<sup>12</sup>158 Ind. 678, 64 N.E. 458 (1902).

<sup>13</sup>Annot., 29 A.L.R. 1460 (1924). See *Curtis v. Mauger*, 186 Ind. 118, 114 N.E. 408 (1916). The *Curtis* case was cited in *Merryweather v. United States*, 12 F.2d 407, 409 (9th Cir. 1926), which held that the failure to obtain leave from a state receivership court barred an action by the United States against the receiver in a federal court.

<sup>14</sup>186 Ind. 118, 114 N.E. 408 (1916).

the roots of the distinction between suits brought in the receivership court and suits brought in other courts arose from the United States Supreme Court's decision in *Barton v. Barbour*.<sup>15</sup> The *Barton* Court held that leave of the court appointing the receiver must be obtained as a jurisdictional prerequisite to maintaining an action against the receiver in another jurisdiction.

*Curtis* described the rationale of the doctrine as the necessity of preventing one set of creditors from gaining an advantage in the enforcement of their claims by proceeding against an estate in a jurisdiction where property could be found but where the receivership court would be without power to prevent injustice to other creditors.<sup>16</sup> Although the doctrine arises out of suits brought in different jurisdictions, it is certainly appropriate for different courts within the same jurisdiction. As a corollary, leave is not required if the action is brought in the receivership court, and the lack of an allegation that leave has been granted will not be fatal to the court's jurisdiction over the derivative action.<sup>17</sup> Thus, Sacks was not without remedy, but the derivative action should have been brought in the Superior Court of Marion County. As the receiver was not properly a party to the derivative action in the circuit court, sustaining the motions to dismiss under Trial Rule 19(B) as to the derivative aspect of the complaint was correct.

Shareholder Sacks was not entirely without success. His contention that it was erroneous to sustain the motions to dismiss because the complaint asserted a personal cause of action against appellees was accepted in part. The court recognized that the primary thrust of the suit was that the corporation had been injured by the alleged derelictions of appellees Blue and AFNB, but noted that Sacks' personal guarantee of the loan to JJS Co. could possibly impose liability on him for the principal amount and be the basis of a personal cause of action.<sup>18</sup> The court relied on the Seventh Circuit's decision in *Buschmann v. Professional Men's Association*<sup>19</sup> and the Fifth Circuit's decision in *Schaffer v. Universal Rundle Corp.*<sup>20</sup> These cases recognized that the same con-

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<sup>15</sup>104 U.S. 126 (1881). *Accord*, *Keen v. Breckenridge*, 96 Ind. 69 (1884).

<sup>16</sup>186 Ind. at 121, 114 N.E. at 409.

<sup>17</sup>*Id.*

<sup>18</sup>279 N.E.2d at 811-12.

<sup>19</sup>405 F.2d 659 (7th Cir. 1969).

<sup>20</sup>397 F.2d 330, 335 (5th Cir. 1972).

duct can result in both a derivative cause of action on behalf of an injured corporation and a personal cause of action for a shareholder when there is a breach of a duty owed specifically to that shareholder separate and distinct from the duty owed to the corporation.<sup>21</sup> The *Sacks* case was cited with approval on this point by the Fifth Circuit in *Empire Life Insurance Co. of America v. Valdak Corp.*<sup>22</sup> The *Empire Life* court relied on the general rule that a shareholder suing for corporate mismanagement must bring the suit derivatively in the name of the corporation unless there is a violation of a duty owing directly to him. In further expounding on this point, the court referred to its earlier *Schaffer* decision in which it said:

[The] exception to the general rule does not arise, however, merely because the acts complained of resulted in damage both to the corporation and to the stockholder, but is confined to cases where the wrong itself amounts to a breach of duty owed to the stockholder personally.<sup>23</sup>

The supreme court concluded that it was not clear that *Sacks* was not entitled to any relief on his complaint,<sup>24</sup> and consequently it reversed the judgment in part and remanded with instruction to treat the motions to dismiss by appellees Blue and AFNB as motions for a more definite statement under Trial Rule 12(E) and to proceed accordingly.<sup>25</sup>

### B. Inspection of Shareholder Lists

In a three to two decision, the Indiana Supreme Court in *State ex rel. Great Fidelity Life Insurance Co. v. Circuit Court*<sup>26</sup>

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<sup>21</sup>279 N.E.2d at 811.

<sup>22</sup>468 F.2d 330, 335 (5th Cir. 1972).

<sup>23</sup>397 F.2d at 896.

<sup>24</sup>*Compare* *Buschman v. Professional Mens' Ass'n*, 405 F.2d 659 (7th Cir. 1969), *with* *Smith v. Parker*, 148 Ind. 127, 45 N.E. 770 (1897), which involved an action for a breach of contract to furnish new capital to a corporation. The court held that the suit was properly dismissed since defendant's promise ran only to the corporation, and the shareholder-plaintiff, who was a guarantor of the loan, had sustained no damage separate from that sustained by the corporation. *See* *John Walker & Sons v. Tampa Cigar Co.*, 197 F.2d 72, 73 (5th Cir. 1952); 1 HARVEY 605.

<sup>25</sup>The court affirmed the granting of the receiver's motion to dismiss AFNB's contention that personal jurisdiction had not been obtained was rejected because, even if it were true, there was no showing that such jurisdiction could not be obtained. Therefore, this was not a proper basis for a motion to dismiss.

<sup>26</sup>288 N.E.2d 143 (Ind. 1972). Justice Givan wrote the majority opinion with Chief Justice Arterburn and Justice Hunter concurring. Justice DeBruler dissented in an opinion with which Justice Prentice concurred.

held that shareholders of an Indiana insurance company were not entitled to judicially compelled examination of the company's books and records, particularly shareholder lists, and that the Indiana Department of Insurance had sole jurisdiction under the provisions of title 27 of the Indiana Code to compel the production of such documents. Relators were Great Fidelity Life Insurance Co., a corporation organized under the insurance laws of Indiana, its officers and directors, and Southern Securities Corp., which owned over fifty per cent of Great Fidelity. The case was initiated by a minority shareholder of Great Fidelity who filed a derivative action alleging a fraudulent conspiracy, gross negligence, and mismanagement of the affairs of the company, and a companion mandamus action against relators seeking the production of the shareholder lists of Great Fidelity and its parent, Southern Securities.<sup>27</sup> Relators then petitioned the supreme court to issue a writ of prohibition commanding the Circuit Court of Posey County and its judge to refrain from proceeding further in both suits.

In resolving dispute, the supreme court, relying on *Lowery v. State Life Insurance Co.*,<sup>28</sup> determined that the derivative action could produce an "order, judgment or decree" interfering with the operation of the business of Great Fidelity contrary to Indiana Code section 27-1-20-23.<sup>29</sup> The *Lowery* court indicated that the rationale behind a similar statute was to preclude suits interfering with "the management of the corporate affairs, and which might produce hopeless confusion, and might impair the efficiency of the company, if not wreck it."<sup>30</sup> *Lowery*, it should be noted, involved an action against an insurance company, but the majority held that the bar applied to actions brought on behalf of insurance companies as well as against them.<sup>31</sup> In fact, the majority, citing *State ex rel. Mid-*

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<sup>27</sup>*Id.* at 144-45. Plaintiffs petitioned the Indiana Department of Insurance to enter the derivative action against the relators, but the Department declined to do so.

<sup>28</sup>153 Ind. 100, 54 N.E. 442 (1899).

<sup>29</sup>IND. CODE § 27-1-20-23 (1971) provides as follows:

No order, judgment, or decree providing for an accounting or enjoining, restraining or interfering with the operation of the business of any insurance company, association, or society, to which any provision of this act is applicable, or for the appointment of a temporary or permanent receiver thereof, shall be made or granted otherwise than upon the application of the department, except in an action by a judgment creditor or in proceedings supplemental to execution.

<sup>30</sup>153 Ind. at 106, 54 N.E. at 444.

<sup>31</sup>288 N.E.2d at 145. See *State ex rel. Mid-West Ins. Co. v. Superior Court*, 231 Ind. 94, 106 N.E.2d 924 (1952).

*West Insurance Co. v. Superior Court*<sup>32</sup> stated that the bar was so complete that the Department of Insurance would have to initiate any proceedings and could not intervene for a plaintiff subsequent to the filing of a legal action.

The majority emphasized that the Department of Insurance has specific authority under the Indiana Insurance Law<sup>33</sup> to order an insurance company to discontinue improper or unsafe practices, and to bring judicial actions against the company, its officers, and agents to obtain compliance.<sup>34</sup> Refusal or inability to return to sound business practices can result in a take-over of the property and business of the insurance company by the Department of Insurance for purposes of rehabilitation.<sup>35</sup> In the event of such a takeover, the Insurance Law provides that the Department of Insurance can bring actions against directors, officers, owners, and agents of the company to enforce claims vested in the company, its shareholders, members, policyholders, or creditors.<sup>36</sup> Thus, the shareholders of Great Fidelity were not without protection, but any malfeasance by Great Fidelity's officials or by Southern Securities that injured Great Fidelity could only be remedied by the Department of Insurance and not in a derivative action. Relying on *Sacks v. American Fletcher National Bank & Trust Co.*,<sup>37</sup> the supreme court ruled that the entire derivative action failed, even as to Southern Securities, when Great Fidelity could not be joined as a party defendant.

The second issue before the court was the propriety of the mandate action for the production of the shareholder lists. Plaintiffs apparently proceeded under the provision of the Indiana General Corporation Act<sup>38</sup> requiring Indiana corporations to keep books and records, including shareholder lists, and to make such records and lists available for inspection by shareholders for "proper purposes."<sup>39</sup> The majority noted that insurance companies

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<sup>32</sup>231 Ind. 94, 106 N.E.2d 924 (1952).

<sup>33</sup>IND. CODE §§ 27-1-1-1 to -22-24 (1971).

<sup>34</sup>*Id.* § 27-1-3-19.

<sup>35</sup>*Id.* § 27-1-4-1. See *Department of Ins. v. Travelers Assur. Co.*, 115 Ind. App. 285, 58 N.E.2d 761 (1945).

<sup>36</sup>IND. CODE § 27-1-4-21 (1971).

<sup>37</sup>279 N.E.2d 807 (Ind. 1972). See discussion of the *Sacks* case at p. 77 *supra*.

<sup>38</sup>IND. CODE §§ 23-1-1-1 to -12-6 (1971).

<sup>39</sup>*Id.* § 23-1-2-14.

are specifically excluded from the General Corporation Act<sup>40</sup> and that the comparable provision in the Indiana Insurance Law did not require that shareholder lists be open for inspection.<sup>41</sup>

If this omission was considered an obstacle to inspection of the lists, it was more apparent than real because the court recognized that the failure to specify shareholder inspection rights in the pertinent statute does not necessarily deny or limit those rights.<sup>42</sup> This is not to say that a shareholder seeking a shareholder list of an insurance company has no problems. As with general corporations, the issue is not so much the right to inspect as it is the recourse available when the corporation denies the right. It is well established that mandamus action is appropriate to test such a refusal by a general corporation,<sup>43</sup> but the majority, consistent with its resolution of the derivative action issue, held that it is for the Department of Insurance to decide whether or not the shareholder wishes to see the records for a "proper purpose."<sup>44</sup>

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<sup>40</sup>*Id.* § 23-1-2-1.

<sup>41</sup>*Id.* § 27-1-7-16.

<sup>42</sup>For authorities on this point and for general discussions of shareholder inspection rights, see 5 FLETCHER § 2213; HENN § 199; LATTIN § 88; 2 ABA-ALI MODEL BUS. CORP. ACT ANN. § 52 (1971); Note, *Shareholders' Right to Inspection of Corporate Stock Ledger*, 4 CONN. L. REV. 707 (1972); Annot., 15 A.L.R.2d 11 (1951).

<sup>43</sup>*Charles Hegewald Co. v. State ex rel. Hegewald*, 196 Ind. 600, 149 N.E. 170 (1925). See also *Indianapolis St. Ry. v. State ex rel. Cohen*, 203 Ind. 534, 181 N.E. 365 (1932); *S.F. Bowser & Co. v. State ex rel. Hines*, 192 Ind. 462, 137 N.E. 57 (1922).

<sup>44</sup>The majority cited the *Hegewald* case for this proposition. The *Hegewald* case did not refer to "proper purpose" in so many words but rather formulated the test that a shareholder is entitled to inspect books, records, and shareholder lists when the "purpose is germane to his interest as [a] stockholder," 196 Ind. at 605, 149 NE. at 173, and "the privilege is sought in good faith for the protection of the interests of the corporation or in his own interests as a stockholder." *Id.*

Of equal importance to the "proper purpose" test is the burden of proof. Indiana is in accord with the jurisdictions that require the corporation to prove that the shareholder does not have a "proper purpose." *Indianapolis St. Ry. v. State ex rel. Cohen*, 203 Ind. 534, 181 N.E. 365 (1932). See Note, *The Burden of Proof as to the Proper Purpose Qualification of the Right of Shareholders to Inspect The Corporate Books and Records in Ohio*, 24 U. CIN. L. REV. 556 (1955). See generally authorities cited note 42 *supra*. Although the court is silent on this point, presumably the common law and statutory standards applicable to general corporations will obtain with respect to insurance companies.



The majority appeared to be unmindful of a distinction made in recent years between the right to inspect corporate books and records and the right to inspect shareholder lists. Generally, fewer restrictions are now imposed on the right to inspect shareholder lists than the right to inspect corporate books and records. The distinction recognizes that there is less opportunity to abuse information obtained from shareholder lists, in contrast to books and records, and that inspection of such lists does not result in as much inconvenience to the continued operation of the corporation.<sup>45</sup> Of course, it must be recognized that the need for shareholders to personally supervise the management of their investment is not as compelling with insurance companies as with general corporations because the former are subject to substantial regulation and control by the Department of Insurance.<sup>46</sup>

Plaintiffs were also denied access to the shareholder lists of Great Fidelity's parent, Southern Securities. Again the majority concluded that the Department had jurisdiction over the matter even though Southern Securities was not an insurance company. The court's reasoning was threefold. First, the Department *must* necessarily have control over a parent of an insurance company with respect to business with the subsidiary; second, the policy of Indiana Code section 27-1-20-23 would be thwarted if actions could be maintained against insurance companies indirectly when they could not be maintained directly; and third, plaintiffs admittedly were seeking control of Great Fidelity and Southern Securities through a proxy contest without having obtained the consent of the Department as required by Indiana Code section 27-1-23-2.<sup>47</sup> Concluding that the De-

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<sup>45</sup>Durnin v. Allentown Fed. Sav. & Loan Ass'n, 218 F. Supp. 716, 718 (E.D. Pa. 1963). For a recent discussion of this trend, see Note, *Shareholders' Right to Inspection of Corporate Stock Ledger*, 4 CONN. L. REV. 707, 710-13 (1972). See generally HENN § 199; LATTIN § 88.

<sup>46</sup>IND. CODE §§ 27-1-1-1 to -22-24 (1971). But see Orloff v. Cosmopolitan Mut. Ins. Co., 31 App. Div. 2d 263, 296 N.Y.S.2d 801 (1969).

<sup>47</sup>IND. CODE §§ 27-1-23-1 to -13 (1971). Section 27-1-23-2 provides in part:

[N]o person shall enter into an agreement to acquire control of a domestic insurer or of any corporation controlling a domestic insurer unless, at the time any such offer, request, or invitation is made or any such agreement is entered into, or prior to the acquisition of such securities if no offer or agreement is involved, such person has filed with the commissioner and has sent to such insurer and any such controlling corporation a statement containing the information required by this section and such offer, request, invitation, agreement or acquisition has been approved by the commissioner in the manner hereinafter prescribed.

partment of Insurance had sole jurisdiction in the matter, the majority made the lower court's writ of prohibition permanent and mandated the circuit court to grant relators' motions to dismiss.

The dissenting justices recognized that Indiana Code section 27-1-20-23 bars, in effect, suits seeking "broad, equitable court orders, judgments and decrees, the effect of which would be to destroy or substantially impair the ability of an insurance company to continue operating as an ongoing business."<sup>48</sup> However, because the statute focused on remedies and not jurisdiction, they construed it as not prohibiting actions that would not materially disrupt the operations of an insurance company or would only do so indirectly. A mandate order directing that a shareholder list be made available to a shareholder for a proper purpose was clearly in the nondisruptive category to the dissenters.<sup>49</sup>

As to Southern Securities the dissenters conceded that, in part, the derivative suit requested remedies prohibited by Indiana Code section 27-1-20-23, and that, to the extent of the statutory prohibition, the trial court had no jurisdiction. However, since Southern Securities was not an insurance company as such, although it owned a majority of Great Fidelity's stock, not all orders would be barred by the statute.<sup>50</sup> Citing *State ex rel. Midwest Insurance Co. v. Superior Court*,<sup>51</sup> as did the majority, the dissenting justices asserted that the circuit court had jurisdiction over suits requesting both prohibited and permitted remedies, as long as the prohibited remedies were denied. Consequently, they concluded that the majority erred in mandating the dismissal of the entire suit.<sup>52</sup>

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The majority appears to have stretched the provision to some degree. Merely obtaining a shareholder list to obtain information is not tantamount to entering into agreements to acquire control of the company through the tender offers or exchange offers which are to be contemplated by the provision. Of course, the court was probably right in anticipating that eventually a transaction clearly encompassed in the section would arise.

<sup>48</sup>288 N.E.2d at 147. The dissenters, interestingly, did not point out that *Lowery v. State Life Ins. Co.*, 153 Ind. 100, 54 N.E. 442 (1899), relied on by the majority, clearly involved direct interference with the operation of the company and not merely the production of a shareholder list.

<sup>49</sup>288 N.E.2d at 148.

<sup>50</sup>*State ex rel. Meade v. Marion Superior Court*, 242 Ind. 22, 174 N.E.2d 208 (1961). Specifically, plaintiff's request that the annual meeting of Great Fidelity be restrained was categorized as a prohibited remedy.

<sup>51</sup>231 Ind. 94, 106 N.E.2d 924 (1952).

<sup>52</sup>288 N.E.2d at 148-49.

### C. Receivers

Receivership was also the issue in the Indiana Supreme Court's decision in *Inter-City Contractors Service, Inc. v. Jolley*.<sup>53</sup> More specifically, the court had to judge the propriety of an order of the Superior Court of Lake County appointing a receiver for Inter-City without notice. The complaint filed by appellee Jolley sought damages for an alleged breach of a merger agreement and requested the appointment of a receiver for the corporation without notice. The trial court appointed a receiver without affording Inter-City an opportunity to be heard. After Inter-City's motion to vacate the trial court order was denied, it perfected an appeal from the trial court's ruling.<sup>54</sup> The supreme court, per Justice Givan, held that the facts alleged in Jolley's complaint were not sufficient to justify the appointment of the receiver and reversed and remanded the judgment with instructions to vacate the appointment order. The court agreed with Inter-City's contention that Jolley had not satisfied the requirements of section 34-1-12-9 of the Indiana Code, which prohibits the appointment of receivers without notice "except upon sufficient cause shown by affidavit." The statute is silent as to what constitutes "sufficient cause," but the elements have been established by several supreme court decisions, primarily *State ex rel. Red Dragon Diner v. Superior Court*<sup>55</sup> and *Albert Johann & Sons v. Berges*.<sup>56</sup>

*Johann*, the leading decision, clearly outlined the foundational showing required to warrant summarily wresting a person's property from him by the appointment of a receiver without the opportunity to be heard in defense. *Johann*, consolidating several earlier rulings into one pleading requirement, established that the appointment of a receiver without notice is appropriate only when a verified complaint or other form of affidavit affirmatively shows: (1) that plaintiff will probably prevail in the action, (2) that there exists cause for the appointment without notice, and (3) that plaintiff's rights cannot adequately be protected by a restraining order or other remedy and, if this is shown, that the emergency necessitating the appointment could not have been

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<sup>53</sup>277 N.E.2d 158 (Ind. 1972).

<sup>54</sup>IND. CODE § 34-1-12-10 (1971) provides for direct interlocutory appeal to the supreme court from decisions appointing or refusing to appoint a receiver for the stay of the receiver's authority until the final determination of such appeal.

<sup>55</sup>239 Ind. 384, 158 N.E.2d 164 (1959).

<sup>56</sup>238 Ind. 265, 150 N.E.2d 568 (1958).

anticipated in time to give notice or that waste, destruction, or loss is threatened, and that delay until notice can be given would defeat the object of the suit.<sup>57</sup>

The court in *Red Dragon Diner* emphasized that the complaint requesting receivership must contain specific facts to establish the ultimate facts as required under *Johann*. Mere conclusions do not suffice.<sup>58</sup> It was this latter requirement that proved fatal to Jolley's case in *Inter-City*. The supreme court reviewed the complaint, and concluded that the allegations essentially contending that Inter-City's financial condition was so precarious that irreparable damage would result if a receiver was not appointed were mere conclusions and, not being supported by specific statements of facts, were insufficient to sustain the order under Indiana Code section 34-1-12-9.<sup>59</sup>

#### D. Record Ownership and Transfer of Shares

A dispute over the record ownership of corporate stock was the issue in *Traylor v. By-Pass 46 Steak House, Inc.*<sup>60</sup> The Indiana Supreme Court affirmed an order of the Superior Court of Vanderburgh County granting temporary injunctive relief in actions brought by the officers and directors of five corporations seeking to regain control over the business affairs of the corporations from defendant-appellants Traylor and Property Developers, Inc. Plaintiffs also sought the records, accounts, and documents of the corporations in defendants' possession and an accounting for the period of time during which they controlled the corporations.<sup>61</sup>

How Traylor, who was a shareholder of the various corporate plaintiffs but not an officer or director of any of them, gained dominion and control over the books, records, and management

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<sup>57</sup>*Id.* at 268, 150 N.E.2d at 569-70. See *Fagan v. Clark*, 238 Ind. 22, 148 N.E.2d 407 (1958); *Morris v. Nixon*, 223 Ind. 530, 62 N.E.2d 772 (1945); *Tormohlen v. Tormohlen*, 210 Ind. 328, 1 N.E.2d 596 (1936). For a discussion of the reasons for appointing receivers, see HENN § 375.

<sup>58</sup>239 Ind. at 386, 158 N.E.2d at 165.

<sup>59</sup>277 N.E.2d at 160. Appellee was not alone in failing to secure the appointment of a receiver without notice. *Johann* is replete with cases in which such appointments were set aside.

<sup>60</sup>285 N.E.2d 820 (Ind. 1972).

<sup>61</sup>*Id.* at 820-21. Appellees were required to post bond of \$60,000 as security for costs and damages under Indiana Rules of Trial Procedure 65(C).

was not disclosed in the opinion.<sup>62</sup> But it was clear that the five appellee corporations, through their officers and directors who were parties to the suit, had refused Traylor's request that the shares standing in his name be transferred to Property Developers, Inc.<sup>63</sup>

Appellants made a two-pronged attack on the order of the superior court and contended that: (1) the corporation had "failed to follow the law" by refusing to transfer the shares on the corporate books, and (2) plaintiffs, because they had refused to transfer the shares, were not entitled to the extraordinary remedy of injunctive relief under the equitable "clean hands" doctrine.<sup>64</sup> The supreme court did not really separate the two issues other than to note that the individual appellees were the duly acting officers and directors of the corporations "and as such are entitled to control the business affairs and assets of the corporations" as provided by the Indiana General Corporation Act.<sup>65</sup> This is unassailable as a general proposition,<sup>66</sup> but there are exceptions recognized in both the statutes and judicial decisions. For example, the General Corporation Act provides that the "power to make, alter, amend or repeal the by-laws of a corporation" is vested in the board of directors unless "otherwise provided in the articles of incorporation."<sup>67</sup> Thus, shareholders can reserve a power ordinarily exercised by the directors of a corporation. Furthermore, there is the now generally accepted concept that shareholders of

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<sup>62</sup>285 N.E.2d at 821.

<sup>63</sup>IND. CODE § 23-1-2-6(g) (1971) provides that the bylaws of a corporation can regulate the manner in which shares are transferable. Another shareholder of one of the corporations and another shareholder of two of them also attempted, without success, to have their shares transferred to Property Developers, Inc. For a general discussion of record ownership and the procedures for transfer of ownership on the share ledgers of the corporation, see 12 FLETCHER § 5492; HENN §§ 176-77; LATTIN § 141.

<sup>64</sup>285 N.E.2d at 821.

<sup>65</sup>IND. CODE § 23-7-1.1-16 (1971). Since that particular provision relates to the incorporation of not-for-profit corporations, the citation apparently is in error. Presumably the court was referring to section 23-1-2-11(a) which provides that "business of every corporation shall be managed by a board of directors." There is no indication that the corporations were anything other than for-profit corporations.

<sup>66</sup>*Id.* § 23-1-2-11(a). *National State Bank v. Sanford Fork & Tool Co.*, 157 Ind. 10, 60 N.E. 699 (1901); *National State Bank v. Vigo County Nat'l Bank*, 141 Ind. 534, 42 N.E. 924 (1895). See 3 FLETCHER § 990; HENN § 207, at 416; LATTIN § 71; 1 ABA-ALI MODEL BUS. CORP. ACT ANN. § 33 (1971).

<sup>67</sup>IND. CODE § 23-1-2-8 (1971).

close corporations can agree among themselves to limit the board of directors, and reserve more authority to themselves than is normally contemplated by the corporation act of jurisdiction, provided that the departure from the corporate norm is not excessive and the interests of creditors or minority shareholders are not jeopardized.<sup>68</sup>

The key question for the supreme court was whether or not plaintiffs' refusal to transfer the Traylor shares and the shares of the other two shareholders complied with the equitable maxim that one who seeks equity must do equity.<sup>69</sup> The court construed that doctrine as requiring intentional or wilful misconduct, and not mere negligence, to bar a plaintiff from otherwise proper equitable relief.<sup>70</sup> It impliedly recognized that a refusal to transfer shares by corporate officers upon request of a shareholder could, under some circumstances, make the officers guilty of "unclean hands." However, the court concluded that the record in this case indicated there was litigation in another tribunal which disputed defendants' ownership of the shares of the five corporations, and hence the refusal was not such a disregard of defendants' rights as to justify application of the doctrine.

Defendants did not seek resolution of the stock ownership dispute in this proceeding, but rather asserted the issue of the ownership only as a defense to the equitable action. This contention was summarily dismissed with the court concluding that the corporate officers were entitled to refuse to transfer the shares until the ownership issue was completely resolved. Even if it was ultimately determined that defendants were entitled to the share transfers, the court felt that the refusal by the plaintiffs would be at worst negligence or a misapprehension of their legal rights. Such conduct could not reasonably be considered a "wilful disregard of the right of appellants,"<sup>71</sup> which would justify denying plaintiffs'

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<sup>68</sup>See *Galler v. Galler*, 32 Ill. 2d 16, 203 N.E.2d 577 (1964); *Katcher v. Ohsman*, 26 N.J. Super 28, 97 A.2d 180 (1953); *Clark v. Dodge*, 269 N.Y. 410, 199 N.E. 641 (1936). See generally HENN § 213; LATTIN § 95; 1 F. O'NEAL, *CLOSE CORPORATIONS* §§ 5.16-17 (1958). See Delaney, *The Corporate Director: Can His Hands Be Tied in Advance?*, 50 COLUM. L. REV. 52 (1950); Comment, "Shareholder Agreements" and the Statutory Norm, 43 CORNELL L.Q. 68 (1957). Cf. *Benner-Corydell Lumber Co. v. Indiana Unemployment Comp. Bd.*, 218 Ind. 20, 29 N.E.2d 776, cert. denied, 312 U.S. 698 (1940).

<sup>69</sup>285 N.E.2d at 822. See *Ferguson v. Boyd*, 169 Ind. 537, 81 N.E. 71 (1907).

<sup>70</sup>285 N.E.2d at 822.

<sup>71</sup>*Id.*

equitable recourse to regain control of the corporate affairs from defendants and the return of the books and records, and to obtain the requested accounting.

### *E. Ownership and Management of Close Corporations*

A falling out among family members over the ownership and control of a close corporation culminated in the decision of the court of appeals in *Grothe v. Herschbach*.<sup>72</sup> The issue on appeal was the propriety of a preliminary injunction entered by the Circuit Court of Jasper County, in a consolidated action,<sup>73</sup> restraining certain corporate claimants from interfering with the operation of the corporation by the president and chief executive officer. The circuit court ruled that the president, Henry Herschbach, had the sole right to draw checks upon the corporation's bank account, and required the president's son to deliver the key to a safe deposit box containing some assets of the corporation.

The court of appeals affirmed the preliminary injunction, which essentially preserved the status quo pending a decision on the merits and held that on the record the trial court had not abused its discretion in granting injunctive relief.<sup>74</sup> The dispute centered around the consequences of a special meeting held on May 11, 1971, particularly as to who was entitled to vote 1299 of the 2000 issued and outstanding shares of the corporation. The record showed that the stock transfer book indicated that the 1299 shares

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<sup>72</sup>286 N.E.2d 868 (Ind. Ct. App. 1972).

<sup>73</sup>As often occurs when discord reigns in family corporations, there was a proliferation of law suits, filings and hearings. The actions involved in the instant case were initiated in 1970 when Jack and Henryelta Herschbach Grothe, the son and daughter of the founder (or one of the co-founders) of an automobile dealership, filed an action to have their father Henry Herschbach and his second wife removed as officers of the corporation; for the appointment of a receiver and for an unspecified permanent injunction. The individual defendants, the corporate trustee under a testamentary trust established by plaintiffs' mother, and the corporation filed a counter complaint. The counter defendants responded with another complaint seeking injunctive and monetary relief against the counter claimants. This action was later consolidated with the initial litigation. The son Jack had also filed suits to have a trust which owned 1299 of the 2000 issued and outstanding shares of the corporation invalidated. The father, who was over 80 when the case was decided, was the trustee. Neither of those cases had been resolved at the time the order in issue was entered. *Id.* at 869-70, 873.

<sup>74</sup>See IND. R. TR. P. 65; Public Serv. Comm'n v. New York Cent. R.R., 247 Ind. 411, 216 N.E.2d 716 (1966); Indiana Annual Conference Corp. v. Lemon, 235 Ind. 163, 131 N.E.2d 780 (1956). See also Public Serv. Comm'n v. Indianapolis Rys. 225 Ind. 30, 72 N.E.2d 434 (1947).

were owned by Henry Herschbach as trustee under a trust created on August 17, 1965.<sup>75</sup> The Indiana General Corporation Act provides that a corporation need only look to its stock transfer book to ascertain the shareholders entitled to vote at shareholder meetings.<sup>76</sup> The court did not, however, rely solely on the record ownership in upholding the injunction. Rather, it examined the trial record and concluded that Henry Herschbach was at least the de facto president and director of the corporation and hence was entitled to preliminarily enjoin pretenders to his office.<sup>77</sup> In upholding Henry Herschbach's claim, the court relied on *Ziffrin v. Ziffrin Truck Lines, Inc.*,<sup>78</sup> which in turn applied the rule of *Schepp v. Evansville Television, Inc.*<sup>79</sup>

In *Ziffrin*, the Indiana Supreme Court held that the evidence sustained the lower court's finding that the board of directors of the truck company was in possession of the corporate "offices, books, bank accounts and other physical properties."<sup>80</sup> Consequently, the board members were de facto officers of the corporation with sufficient color of title to authorize the corporation to bring an action to enjoin other claimants from acting as officers until their entitlement was established by law. The *Schepp* court, in expounding on the rights of incumbent office holders, phrased the pertinent principle as follows:

The rule is well settled that a claimant to an office may be enjoined by one occupying the office under a claim

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<sup>75</sup>286 N.E.2d at 877. The 1299 shares had previously been owned by the president's son, Jack Herschbach.

<sup>76</sup>IND. CODE § 23-1-2-9(h) (1971). See *State ex rel. Breger v. Rusche*, 219 Ind. 559, 39 N.E.2d 433 (1942). Indiana is in accord with the prevailing view in this respect. See 5 FLETCHER § 2033; HENN § 176, at 328; LATTIN § 89.

<sup>77</sup>286 N.E.2d at 873-74. At the May 11, 1971, meeting two conflicting sets of minutes were prepared. One set, prepared at the instance of Henry Herschbach disclosed that the shareholders took no action to remove officers or directors and elected no new directors. The second set, prepared at the instance of the claimants, indicated that Jack Herschbach, the president's son, purported to vote the 1299 shares for himself and 640 shares as proxy for his sister, and elected his wife, his sister and the former officer of the corporation as the three directors of the corporation. His wife was then purportedly elected president. She spent no time on the premises of the corporation and her only act as "president" was to direct a letter to the bank asserting her claim to the office and warning them not to honor the signature of Henry Herschbach.

<sup>78</sup>239 Ind. 468, 158 N.E.2d 793 (1959).

<sup>79</sup>236 Ind. 472, 141 N.E.2d 437 (1957).

<sup>80</sup>239 Ind. at 472, 158 N.E.2d at 795.



of right until the former shall have established his title in an action at law. Thus will equity protect the *possession* of the incumbent from any unlawful intrusion.<sup>81</sup>

It is well-established that to determine the title of officers or directors or to test the validity of an election of corporate officers, *quo warranto* actions, or information in the nature of *quo warranto*, is the proper remedy.<sup>82</sup> Hence, injunctive relief is merely a device to maintain the status quo until the title issue is resolved.

The primary element of the rule protecting possession of corporate office is that the incumbent acting as *de facto* officer must be doing so under color of title. The Seventh Circuit in *In re Bankers Trust*<sup>83</sup> cited *Schepp* as being in accord with the proposition that "color of right or title merely means 'authority derived from an election or appointment, however irregular or informal, so that the incumbent not be a mere volunteer.'"<sup>84</sup> The authorities generally specify that there must be an exercise of the assumed authority before the *de facto* doctrine applies.<sup>85</sup>

The *Herschbach* opinion did not make it absolutely clear that Henry Herschbach took office because of an election. It is not unlikely that he did, since he was the only person who had acted as president of the corporation for forty years. In essence, the court gave great weight to Herschbach's past performance of duties and possession of corporate property prior to the contested meeting in determining his *de facto* status for purposes of passing on the preliminary injunction.<sup>86</sup>

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<sup>81</sup>236 Ind. at 481-82, 141 N.E.2d at 441 (emphasis added). See *Felker v. Caldwell*, 188 Ind. 364, 123 N.E. 794 (1919); *Carmel Natural Gas & Improvement Co. v. Small*, 150 Ind. 427, 47 N.E. 11 (1897).

<sup>82</sup>*Smith v. Bank of State of Indiana*, 18 Ind. 327 (1862); 2 FLETCHER § 387; HENN §§ 206, 222; LATTIN § 76.

<sup>83</sup>403 F.2d 16 (7th Cir. 1968).

<sup>84</sup>*Id.* at 20 quoting from 2 FLETCHER § 374, at 203. See also HENN § 206, at 222; LATTIN § 76.

<sup>85</sup>2 FLETCHER § 374; HENN §§ 206-22; LATTIN § 76.

<sup>86</sup>286 N.E.2d at 877. Although it did not appear to be in issue, it should be noted that there is some authority that an officer elected by an illegally constituted board of directors is without color of right or title and is not entitled to the salary provided for him even if he renders services in good faith believing he has *de jure* status. *Waterman v. Chicago & I.R.R.*, 29 N.E. 689 (1892). Lattin criticizes this as a "dubious and unjust principle." LATTIN § 77, at 264.

The court distinguished *Hutton v. School City*,<sup>87</sup> relied on by the Herschbach children. In *Hutton* the court stated that:

The general rule is that mandatory injunctions will not issue to deprive a person of property of which he is in possession under claim of ownership, until after the cause has been fully heard, when it comes up for final decree. And in the absence of extraordinary circumstances, of a character not shown to exist in the case at bar, such an order should not issue.<sup>88</sup>

The reasoning behind asserting that *Hutton* supported the children's position is not clear since there was little doubt that Henry Herschbach, and not the children, had possession and control of the corporation except to the extent that it had been usurped by the children. Perhaps it was merely cited for the proposition that courts should exercise judicial restraint in issuing mandatory injunctions, particularly since Henry Herschbach's daughter-in-law at least claimed that she had been elected president at the May 11th meeting.<sup>89</sup>

In addition, the court of appeals concluded that Henry Herschbach's petition for preliminary injunctive relief demonstrated an "impending injury" or "urgent necessity" which demanded the immediate interposition of injunction within the rule of *Public Service Commission v. New York Central Railroad*.<sup>90</sup> Henry Herschbach's age, the claimants impeding of the normal operation of the corporation, including the payment of bills and the purchase of automobiles, and their asserted ownership claim to substantial bank accounts and negotiables satisfied this requirement with no difficulty.<sup>91</sup>

#### F. Earnings and Dividends

The Appellate Court of the State of Illinois applied Indiana law in *Kern v. Chicago & Eastern Illinois Railroad*,<sup>92</sup> an action seek-

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<sup>87</sup>194 Ind. 212, 142 N.E. 427 (1924).

<sup>88</sup>*Id.* at 219, 142 N.E. at 430.

<sup>89</sup>See note 77 *supra*.

<sup>90</sup>247 Ind. 411, 421, 216 N.E.2d 716, 723 (1966).

<sup>91</sup>286 N.E.2d at 871, 874.

<sup>92</sup>285 N.E.2d 501 (Ill. App. 1972). The court held that the law of Indiana, the state of incorporation, applied. See *Guttman v. Illinois Cent. R.R.*, 91 F. Supp. 285 (E.D.N.Y. 1950), *aff'd*, 189 F.2d 927 (2d Cir. 1951).

ing to compel the payment of a dividend on preferred stock for the year 1959. The issue on appeal was the correctness of the C. & E.I.'s computations supporting its conclusion that there were no net earnings available for dividends on the Class A preferred shares.

The C. & E.I. was incorporated in Indiana in 1939 pursuant to a reorganization proceeding supervised by the Interstate Commerce Commission. The reorganization provided for a Class A preferred stock with a par value of forty dollars per share and a maximum annual dividend rate of two dollars. The dividends were cumulative to the extent earned.<sup>93</sup> During March 1965, the C. & E.I. made an exchange offer to Class A preferred shareholders offering forty dollars in C. & E.I. common shares plus six dollars in dividends that had been accrued and unpaid on the Class A shares. The Class A shares that were not exchanged pursuant to the offer were called for redemption in July 1965 at a price of \$47.17.<sup>94</sup> The terms of both the exchange offer and the redemption notice stated that no dividends for the year 1959 had been accrued and unpaid on the Class A shares. In fact, the railroad's records indicated a deficiency in net earnings available for dividends in 1959. Plaintiffs continued to hold their shares and had neither exchanged them nor delivered them upon redemption.<sup>95</sup>

Plaintiffs urged two theories in support of their claim for the two dollars dividend: (1) that the undistributed 1959 earnings of a C. & E.I. wholly owned subsidiary, Chicago Heights Terminal Transfer Railroad Co. (C.H.T.T.), should have been included in the

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<sup>93</sup>The C. & E.I. articles of incorporation provided that:

If in any year there shall not be net earnings available for dividends, or if the amount of net earnings available . . . shall be less than the maximum dividend requirement . . . the deficiency shall not be made good in any subsequent year, nor shall any dividends accumulate with respect thereto.

285 N.E.2d at 502.

As Henn points out, "cumulative-to-the-extent-earned" preferred stock is a hybrid variety of dividend preference "under which unpaid dividends accumulate during past fiscal periods only to the extent that there were then funds legally available to pay such dividends." HENN § 124, at 209. See also *id.* §§ 324-25.

<sup>94</sup>The redemption price represented the \$40 par value of the share plus \$7.17 in dividends which were then "accrued and unpaid."

<sup>95</sup>285 N.E.2d at 503. The suit claimed dividends for persons who had exchanged or who had had their Class A shares redeemed or who, like plaintiffs, continued to hold them. *Id.* at 502.

C. & E.I. income accounts;<sup>96</sup> and (2) that Illinois real estate tax refunds for the year 1959 were credited to the income accounts of the years received whereas the accounts for the year 1959 should have been reopened and adjusted.<sup>97</sup>

Plaintiffs' first theory required an interpretation of C. & E.I.'s articles of incorporation. Indiana, as the court noted, is in accord with most jurisdictions and recognizes that the rights of preferred shareholders are contractual in nature with the articles of incorporation serving as the contract.<sup>98</sup> The pertinent provisions of the C. & E.I. articles provided that "net earnings available for dividends" to Class A shareholders were the same as "income available for contingent charges"<sup>99</sup> as computed in accordance with the 1939 Uniform System of Accounts for railroads adopted by the Interstate Commerce Commission.<sup>100</sup> The Uniform System of Accounts in turn provided that:

Income accounts are those designed to show, as nearly as practicable, for each fiscal period . . . the returns accrued upon investments. . . . The net balance of income (or loss) shall be carried to Profit and Loss.<sup>101</sup>

The crux of the decision was whether the undistributed earnings of C.H.T.T. had accrued to C. & E.I., which in turn depended on whether or not the "corporate fiction" of C.H.T.T. would be disregarded. The appellate court upheld the circuit court's conclusion that C.H.T.T. had been operated as a separate entity from C. & E.I. in 1959, and, consequently, the only "return accrued upon investment" was the \$300,000 dividend that had been declared in 1959 and not the undistributed income.<sup>102</sup> This result reflects the

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<sup>96</sup>The C.H.T.T. had net earnings of \$392,193 for 1959 of which \$300,000 was paid out as a dividend to the parent corporation. This sum was included in C. & E.I.'s income accounts for 1959. The balance of \$92,193 in undistributed earnings was not considered by C. & E.I. as income nor as net earnings available for dividends. *Id.* at 503.

<sup>97</sup>It was stipulated that the net tax refunds were sufficient to pay the \$2 dividend for 1959. *Id.* at 505.

<sup>98</sup>*Rubens v. Marion-Washington Realty Corp.*, 116 Ind. App. 55, 59 N.E.2d 907 (1945). See HENN § 124; LATTIN §§ 129-30.

<sup>99</sup>285 N.E.2d at 503. Income available for contingent charges was defined as income less fixed charges less certain specified sums.

<sup>100</sup>ICC Reg. C, 49 C.F.R. § 514 (1972).

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

<sup>102</sup>285 N.E.2d at 504.

well-established rule that there is no "dividend" nor is there a right for a shareholder to demand or receive a dividend until it has been declared by proper action of the corporation's board of directors,<sup>103</sup> except under extraordinary circumstances such as refusing to declare preferred dividends when funds are legally available and the refusal indicates bad faith or oppressive conduct on the part of the board. In such cases equity will compel the board to act.<sup>104</sup>

The Illinois court appeared to recognize that a contrary result would be appropriate if the facts justified disregarding the corporate fiction of C.H.T.T. and treating the two entities as one. However, there was little doubt that C. & E.I. had maintained its wholly owned subsidiary as a separate entity. In fact, support for the conclusion was drawn from C. & E.I.'s efforts to effect a merger of the two companies. The efforts failed when the ICC refused to approve the proposals and specified that C.H.T.T. was to be maintained as a distinct corporate entity.<sup>105</sup> Thus, a conclusion that the two corporations were in fact one would require the conclusion that C. & E.I. had violated the Interstate Commerce Act.<sup>106</sup> The trial court record also indicated that the Director of Accounts of the ICC had advised C. & E.I. that the Uniform System of Accounts did not require the transfer of earnings from a subsidiary to its parent.<sup>107</sup> The conclusion was further buttressed by affidavits showing that C.H.T.T. had always maintained separate books and records from its parent.<sup>108</sup>

The second theory of plaintiffs also failed to persuade the appellate court. Again it was the Director of the Bureau of Ac-

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<sup>103</sup>Rubens v. Marion-Washington Realty Corp., 116 Ind. App. 55, 63, 59 N.E.2d 907, 910 (1945); *See also* Franklin County Distrib. Co. v. C.I.R.R., 125 F.2d 800, 805 (6th Cir. 1942); Cintas v. American Car & Foundry Co., 131 N.J. Eq. 419, 25 A.2d 418, 422 (1942); HENN §§ 327-28; LATTIN § 146.

<sup>104</sup>W.Q. O'Neill Co. v. O'Neill, 108 Ind. App. 116, 25 N.E.2d 656 (1940). *See* Rubens v. Marion-Washington Realty Corp., 116 Ind. App. 55, 59 N.E.2d 907 (1945); Dodge v. Ford Motor Co., 204 Mich. 459, 170 N.W. 668 (1919); HENN § 328.

<sup>105</sup>Chicago & Ill. R.R. Merger, 312 I.C.C. 564 (1961).

<sup>106</sup>49 U.S.C. § 5(1) (1970). Courts are reluctant to disregard the corporate fiction when to do so will require a conclusion that the corporations have acted unlawfully. *See* Berkey v. Third Ave. Ry., 244 N.Y. 84, 155 N.E. 58 (1926) (Cardozo, J.).

<sup>107</sup>285 N.E.2d at 504. C. & E.I.'s independent auditor concurred in this judgment. *Id.*

<sup>108</sup>*Id.*

counts for the ICC that thwarted their efforts to establish that there were sufficient net earnings in 1959 to fund the Class A dividends. In this respect the record indicated that it would be inappropriate to reopen and adjust the accounts for 1959 "for the purpose of recording subsequent years transactions (the refunds). . . . Adjustments of this kind should be lodged in either current income or expense accounts of appropriate retained income accounts."<sup>109</sup> C. & E.I.'s auditors opined that the refunds should be credited to the retained earning account to preclude a material distortion of the income account.<sup>110</sup>

The court also rejected plaintiffs' contention that a provision in the articles providing that adjustments to "income accounts of prior years shall be treated as income items *for the year in which entered on the books*"<sup>111</sup> referred to the year of the original entry and held that the reference was to the year in which the adjusting entry was made. Thus, an express provision of the articles refuted plaintiffs' argument that prior year accounts were to be reopened.<sup>112</sup>

#### G. Statutory Developments

The 1973 Session of the Indiana General Assembly enacted several pieces of legislation significantly amending the Indiana General Corporation Act and the Indiana Insurance Law.<sup>113</sup>

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<sup>109</sup>*Id.* at 505.

<sup>110</sup>*Id.*

<sup>111</sup>*Id.* (emphasis in original).

<sup>112</sup>*Id.* at 505-06. In fact, the court noted that "net earnings available for dividends" in 1959 were enhanced by refunds received in 1959 from real estate taxes paid in prior years. In other words, plaintiffs perhaps should have taken pleasure from the fact that the deficiency in 1959 would have been greater if the accounts for prior years had been reopened.

<sup>113</sup>Other enactments by the General Assembly in the corporate area include: (1) Ind. Pub. L. No. 269 (April 12, 1973), which intriguingly amended IND. CODE § 27-1-2-2 (1971) to provide that the Indiana Insurance Law does not apply to not-for-profit corporations that pay death benefits to owners of valuable registered horses; (2) Ind. Pub. L. No. 248 (April 10, 1973), which amended IND. CODE § 23-7-1.1-7 (1971) to provide that loans to not-for-profit corporations by members can bear "reasonable interest at a rate not in excess of current market rates." The prior language limited interest rates to not in excess of 6% per annum. The amendment does not define "reasonable" or "current market rates" so it does present some potential construction problems. The legislature no doubt intended to liberalize the interest provision and the courts will probably interpret it accordingly. One possible guideline would be the interest rates given by comparable corporate

### 1. Insurance Company Mergers and Consolidations

The Indiana Insurance Law relating to mergers<sup>114</sup> and consolidations<sup>115</sup> of domestic insurance companies was amended<sup>116</sup> to bring it into substantial conformance with the merger and consolidation provisions of the Indiana General Corporation Act.<sup>117</sup>

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ventures in the regular bond or debenture market; (3) Ind. Pub. L. No. 64 (April 6, 1973), which amended the Public Service Commission Law, IND. CODE §§ 8-1-1-1 to -23-5 (1971) by adding a new chapter numbered 24 which eliminated the requirement that the Indiana Public Service Commission approve the issuance of securities of federally-regulated gas pipeline companies or the sale or other transfer of the facilities of such companies and exempted such companies from Commission regulation with respect to their securities; (4) Ind. Pub. L. No. 245 (April 16, 1973), which amended IND. CODE §§ 23-1-11-1 to -16 (1971) by adding a new section numbered 1.5, which provided that foreign financial institutions purchasing evidence of indebtedness from domestic investing or lending institutions are not for that reason alone "transacting business" in the state for purposes of qualification; (5) Ind. Pub. L. No. 266 (April 13, 1973), which amended IND. CODE § 26-1-8-102 (1971) and reduced the stock ownership requirement of "clearing corporations" from 100% to 90% provided that the remaining stock is owned by directors of such corporations and only to the extent such ownership is necessary to permit them to qualify as directors; (6) Ind. Pub. L. No. 277 (April 19, 1973), which amended IND. CODE § 27-1-13-3(2)(c) (1971) to permit casualty, fire, and marine insurance companies to invest in bonds, notes, or other evidence of indebtedness issued and guaranteed by a local governmental unit of a state, territory, or possession of the United States, the District of Columbia, or a province of the Dominion of Canada under certain conditions; (7) Ind. Pub. L. No. 279 (April 23, 1973), which amended IND. CODE §§ 27-6-8-17, -18 (1971) by extending from 90 days to 6 months the automatic stay of legal proceedings wherein an insolvent insurance company is a party or is required to defend a party, and to clearly require the liquidator or receiver of an insolvent insurance company to make records available to the Board of the Indiana Insurance Guarantee Association. The Association is responsible for the quick payment of claims against insolvent insurance companies and for the detection and prevention of such insolvencies.

<sup>114</sup>IND. CODE § 27-1-9-3(a) (3) (1971).

<sup>115</sup>*Id.* §§ 27-1-9-1 to -15.

<sup>116</sup>Ind. Pub. L. No. 272 (April 17, 1973). The Act was deemed an emergency measure and became effective upon passage.

<sup>117</sup>IND. CODE § 23-1-5-2(a) (3) (1971) (mergers); *id.* § 23-1-5-3(a) (3) (consolidations).

The Indiana Insurance Law and the General Corporation Act now comport with the approach to mergers and consolidations adopted by the drafters of the 1969 revision of the Model Business Corporation Act.

2 ABA-ALI MODEL BUS. CORP. ACT ANN. §§ 71, 72 (1971). The prior Model Act provisions, 2 ABA-ALI MODEL BUS. CORP. ACT ANN. §§ 65, 66 (1960), like prior Indiana law, limited conversions to the shares, obligations, or other securities of the surviving or new corporation. This restriction was

The major revision was the addition of language permitting the agreement of merger or consolidation to provide for the conversion of the shares of participating stock corporations into something other than the "shares or other securities" of the surviving or new corporation. Conversions into such securities are still permitted, but the Insurance Law now provides that the shares of each party to a merger, other than the surviving corporation, and the shares of each party to a consolidation can be converted "in whole or in part, into cash, property, shares or obligations of any other corporation."<sup>118</sup>

The only significant difference remaining between the current merger and consolidation provisions of the Insurance Law and the General Corporation Act is that the Insurance Law merger provision still contains the phrase "other than the surviving corporation" as a limitation on its conversion authority.<sup>119</sup> It is unclear why this restrictive language was carried over from the previous merger provision. Since the term "merger" means the absorption of one or more corporations by an existing corporation which continues to survive, the phrase seems redundant.<sup>120</sup> If the shares of the "surviving corporation" are changed or converted, *i.e.* a new corporation is created,<sup>121</sup> then the fundamental corporate change is not a merger, but rather a consolidation. Perhaps the retention of the phrase can be explained as a legislative oversight. The General Corporation Act, prior to the 1969 amendment broadening the conversion provision of the merger section,<sup>122</sup> also contained the phrase. It was initially carried over into the 1969 amendment but eventually was deleted.<sup>123</sup> A similar deletion in section 27-1-9-3(a) (3) of the Insurance Law might be anticipated in the future.

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characterized as "needlessly restrictive and out of harmony with modern practices." 2 ABA-ALI MODEL BUS. CORP. ACT ANN. §§ 71, 72, at 352 (1971).

<sup>118</sup>This is the language added to the consolidation provision, IND. CODE § 27-1-9-4(a) (3) (1971). The amendment to the merger provision, *id.* § 27-1-9-3(a) (3), was identical except that the word "other" before the word "corporation" was omitted. The same difference is found in the merger and consolidation provisions of the General Corporation Act.

<sup>119</sup>*Id.* § 27-1-9-3(a) (3).

<sup>120</sup>HENN § 346, at 713; LATTIN § 170, at 613. See 2 ABA-ALI MODEL BUS. CORP. ACT ANN. §§ 71, 72 (1971). For an extensive bibliography on mergers and consolidations, see HENN § 346, at 713 n.l.

<sup>121</sup>HENN § 346, at 713; LATTIN § 170, at 613.

<sup>122</sup>IND. CODE § 23-1-5-2(a) (3) (1971).

<sup>123</sup>Ind. Pub. L. No. 179, § 2(a) (3) (Feb. 16, 1972).



The effect of the amendments, as they refer expressly to "cash, property, shares or obligations of other corporations," will be to increase the flexibility available in planning the merger or consolidation of Indiana insurance companies. For example, the shareholders of merged corporations are now permitted to receive securities of the surviving corporation's parent which might have marketability or other advantages over the shares, obligations or securities of the surviving corporation.

## 2. Insurance Company Short Form Mergers

Also adopted by the General Assembly was a new "short form" acquisition provision authorizing a parent corporation that owns (directly or indirectly) ninety-five per cent of the voting stock of a domestic insurance company to acquire the minority interests without the approval of the shareholders of either corporation.<sup>124</sup> The new provision, which applies to both foreign and domestic parent corporations, provides for the adoption of a plan of acquisition by the board of directors of the parent whereby the minority interests of the subsidiary will be acquired in exchange for the "shares or other securities of the parent corporation, or cash, other consideration, or any combination of the foregoing. . . ."<sup>125</sup>

Since insurance companies are involved, the merger plan requires approval by the Indiana Insurance Commissioner before it can become effective. Such approval is contingent on satisfying the Commissioner "that the terms and conditions of the plan of acquisition are fair and reasonable."<sup>126</sup> In this respect the enactment differs significantly from the short form merger provision of the Indiana General Corporation Act<sup>127</sup> and accords minority shareholders greater protection of their interests. The two acts

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<sup>124</sup>Ind. Pub. L. No. 278 (April 12, 1973). This was deemed an emergency measure and became effective immediately on passage. Specifically, this act amended IND. CODE §§ 27-3-1-1 to -2-9 (1971) by adding an additional chapter numbered 3.

<sup>125</sup>Ind. Pub. L. No. 278 (April 12, 1973). Interestingly, the exchange provision is less flexible than the amendments to the general merger and consolidation provisions of the Insurance Law which now permit the conversion of minority shares into shares of "other" corporations. See discussion of amended IND. CODE §§ 27-1-9-3(a)(3), -4(a)(3) (1971) p. 100 *supra*. The new provision is also more restrictive than the short form merger section of the General Corporation Act, IND. CODE § 23-1-5-8 (1971).

<sup>126</sup>Ind. Pub. L. No. 278 (April 12, 1973).

<sup>127</sup>IND. CODE § 23-1-5-8 (1971). For general discussions of short form mergers, some critical of the device, see 2 ABA-ALI MODEL BUS. CORP. ACT ANN. § 75, Annot. 2 (1971); HENN § 346, at 715 n.8; Note, *Elimination of*

also differ with respect to the procedures and methods for appraising the value of the shares of shareholders dissenting from the acquisition plan, and the consideration offered thereunder.<sup>128</sup>

Under the provisions of the new enactment, dissenting shareholders have thirty days after receipt of the plan, or a summary of it, to notify the company in writing of their dissent from the plan and to demand the "fair value . . . [of the voting stock] as of the day prior to the date on which the plan of acquisition was adopted by the board of directors of the parent corporation, excluding any appreciation or depreciation in anticipation of, or resulting from, that corporate action."<sup>129</sup> The Act further provides for judicial appraisal of the shares of the subsidiary if the shareholder does not agree with the value deemed fair by the subsidiary. Although the appraisal remedy has been criticized at times as having questionable value for shareholders of publicly held corporations,<sup>130</sup> it is certainly not inappropriate when minority shareholders have no established market through which they can dispose of their holdings.

Section 4 of the new act provides that the parent corporation and the now wholly-owned subsidiary insurance company shall be deemed separate and distinct corporations with neither "having any liability to the creditors, policy holders, if any, or shareholders of the other, notwithstanding any actions or omissions of the officers, directors or shareholders of either or both of the corporations."<sup>131</sup> This legislative restriction on disregarding the corporate fiction is also found in the provision relating to the exchange of insurance securities of other than ninety-five per cent owned subsidiaries.<sup>132</sup>

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*Minority Share Interests by Merger: A Dissent*, 54 NW. U.L. REV. 629 (1959); Comment, *The Short Merger Statute*, 32 U. CHI. L. REV. 59 (1965). Although they have been attacked, short form merger statutes have been upheld as constitutional. *Coyne v. Park & Tilford Distillers Corp.*, 37 Del. Ch. 558, 146 A.2d 785 (1958); *Alpren v. Consolidated Edison Co.*, 168 Misc. 381, 5 N.Y.S.2d 254 (Sup. Ct. 1938).

<sup>128</sup>Ind. Pub. L. No. 278 (April 12, 1973).

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

<sup>130</sup>Compare Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coher*, 72 YALE L.J. 223 (1962), with Eisenberg, *The Legal Roles of Shareholders and Management in Modern Corporate Decisionmaking*, 57 CALIF. L. REV. 1 (1969). See also Banks, *A Selective Inquiry into Judicial Stock Valuation*, 6 IND. L. REV. 19 (1972).

<sup>131</sup>Ind. Pub. L. No. 278 (April 12, 1973).

<sup>132</sup>IND. CODE § 27-3-1-7 (1971).

### 3. Corporate Fees

Of particular interest in the corporate area was the amendment to Indiana Code section 23-3-2-1<sup>133</sup> increasing fees for certain corporate activities effective May 1, 1973.<sup>134</sup> A fee schedule reflecting these increases is available from the Office of the Secretary of State of Indiana.

### 4. Indemnification of Corporate Personnel

The General Assembly altered in several respects the provisions of the Indiana General Corporation Act relating to the indemnification of corporate personnel against expenses incurred in defending liability claims and for insurance covering such claims.<sup>135</sup> It also extended similar protection to insurance corporation personnel by adding nearly identical language to the powers section of the Indiana Insurance Law.<sup>136</sup> The General Assembly extended the corporate power to indemnify corporate personnel and clearly authorized the purchase and maintenance of insurance on behalf of such persons against any liability asserted against or incurred by them even though the corporation itself might lack the power to indemnify them otherwise.

The first significant change effected by the legislation was the inclusion of past or present "employees and agents" among those persons who may be indemnified by the corporation or on whose behalf liability insurance may be obtained. Previously, only past or present "directors or officers" of the corporation were covered. In making this change, Indiana adopted the position of the drafters of the indemnification provision of the Model Busi-

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<sup>133</sup>Ind. Pub. L. No. 247 (April 17, 1973). This was deemed an emergency measure and became effective on May 1, 1973.

<sup>134</sup>There were also some minor style and form changes in the provisions of IND. CODE §§ 23-3-2-1 to -5 (1971). However, these have no substantive effect.

<sup>135</sup>*Id.* §§ 23-1-1-2(b) (9) to -2(b) (10), as amended Ind. Pub. L. No. 244 (April 10, 1973).

<sup>136</sup>*Id.* § 27-1-7-2(b) (8) to -2(b) (9), as amended Ind. Pub. L. No. 271 (April 13, 1973). Indiana Public Laws 244 and 271 were designated emergency measures and became effective immediately after passage. Since the language of the Insurance Law provisions is identical to the two relevant sections of the General Corporation Act (except for some minor differences required by the differences between insurance and general corporations) the discussion will focus on amended section 23-1-2-2(b) (9) and the new section 23-1-2-2(b) (10) of the General Corporation Act. The provisions authorize corporations

ness Corporation Act<sup>137</sup> and joined the minority of jurisdictions<sup>138</sup> recognizing the need to indemnify personnel below the top echelons of the corporate structure in order to attract and keep competent employees.<sup>139</sup>

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to indemnify any person who is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, against expenses reasonably incurred by him in connection with the defense of any action, suit or proceeding, civil or criminal, in which he is made or threatened to be made a party by reason of being or having been in any such capacity, or arising out of his status as such, except in relation to matters as to which he is adjudged in such action, suit or proceeding, civil or criminal, to be liable for negligence or misconduct in the performance of duty to the corporation: Provided, however, that such indemnification shall not be deemed exclusive of any other rights to which those indemnified may be entitled under any provision of the articles of incorporation, by-laws, resolution, or other authorization heretofore or hereafter adopted, after notice, by a majority vote of all the voting shares then issued and outstanding; [and]

. . . to "purchase" and "maintain" insurance on behalf of any person who is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against any liability asserted against him and incurred by him in any such capacity, or arising out of his status as such, whether or not the corporation would have the "power to indemnify" him against such liability under the provisions of this section. . . .

Ind. Pub. L. No. 244, §§ 2(b)(9)-(10) (April 10, 1973); Ind. Pub. L. No. 271 §§ 2(b)(8)-(9) (April 13, 1973).

<sup>137</sup>1 ABA-ALI MODEL BUS. CORP. ACT ANN. § 5 (1971). The Annotation observes that the development of indemnification statutes was prompted by the decision in *New York Dock Co. v. McCollom*, 173 Misc. 105, 16 N.Y.S.2d 844 (Sup. Ct. 1939), which denied a common law right of indemnification. *Solimine v. Hollander*, 129 N.J. Eq. 264, 19 A.2d 344 (1941); *Mooney v. Willys-Overland Motors, Inc.*, 204 F.2d 888 (3d Cir. 1953).

<sup>138</sup>The Model Act Annotation lists Connecticut, Massachusetts, and Minnesota as authorizing indemnification of agents and employees as well as officers and directors. California, Ohio, Rhode Island, and South Carolina include employees in their statutes. Connecticut goes still further and protects shareholders of the corporation as does North Carolina under some circumstances.

<sup>139</sup>Recognized is a need for protection apart from whatever protection is enjoyed by them under the general principles of agency law. See HENN § 379, at 800 n.2; W. SEAVEY, *LAW OF AGENCY* § 168 (1964); RESTATEMENT (SECOND) OF AGENCY §§ 439-40 (1958).

A related change effected by the legislation was the extension of indemnification to persons serving, or who had served, as directors, officers, employees, or agents of another "corporation, partnership, joint venture, trust or other enterprise" if the person is or was serving at the request of the indemnifying corporation. The previous language of section 23-1-2-2(b) (9) encompassed only persons serving as "directors or officers" of other corporations. Thus while the old provision extended protection to persons serving in top managerial positions of corporations such as subsidiaries, the current provision recognizes that other forms of business enterprise beside the corporate are appropriate in many instances<sup>140</sup> and accordingly extends the indemnification power.

It should be pointed out that the former statutory provision did not *preclude* indemnification of employees or agents, or corporate personnel serving in other business enterprises. It specifically provided that the indemnification authority granted by the General Corporation Act was not "exclusive" and permitted indemnification pursuant to the "articles of incorporation, bylaws, resolution, or other authorization heretofore or hereafter adopted, after notice, by a majority vote of all the voting shares then issued and outstanding."<sup>141</sup> Consequently, the benefits of indemnification could be accorded by director or shareholder action in situations not encompassed within the provision itself, including those situations now covered by the amended provisions. The nonexclusive feature of most statutes has been criticized as lessening the protection given to the interests of the corporation's owners. Having the scope of indemnification specified in the General Corporation Act is a more satisfactory procedure because the limits of proper indemnification are set forth.<sup>142</sup>

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<sup>140</sup>For a general discussion of such other forms of doing business, see HENN §§ 16-76.

<sup>141</sup>IND. CODE § 23-1-2-2(b) (9) (1971). The Model Act indemnification provision is nonexclusive, as apparently are the statutes in the majority of jurisdictions. 1 ABA-ALI MODEL BUS. CORP. ACT ANN. § 5, at 225 (1971). See HENN § 379, at 806; LATTIN §§ 78, at 281, 114, at 449-50. See also L. RATNER, PROTECTING THE CORPORATE OFFICER AND DIRECTOR FROM LIABILITY (1970); Jervis, *Corporate Agreements to Pay Directors' Expenses in Stockholder Suits*, 40 COLUM. L. REV. 1192 (1940).

<sup>142</sup>See HENN §§ 379-80; LATTIN §§ 78, 114. It is important to note that there is authority cautioning against overreliance on such provisions when indemnification goes substantially beyond the statute or when it could be characterized as unjust or inequitable. *Teren v. Howard*, 322 F.2d 949 (9th Cir. 1963); cf. *Koster v. Warren*, 297 F.2d 419 (9th Cir. 1961). Another risk is that any bylaw or other provision concerning indemnification could be deemed, if poorly drafted, as restricting rather than expanding available

One change effected by the amendment that might be of questionable wisdom was the deletion of "actually" with respect to the expenses covered by the provision, leaving "reasonably incurred" as the only limit on the expenses covered. The problem is not that the standard of accounting has been reduced in fact, rather, it is that it might *appear* that the standard has been reduced. This appearance of a reduced standard could encourage a less careful attitude in defending claims or actions brought against corporate personnel. Of course, one argument in favor of deleting "actually" is that the statute now clearly permits the corporation to make advances to a covered person to finance his defense or to make payments directly to a third party such as an attorney rather than having the indemnified person pay the expense and in turn seek reimbursement. Unfortunately, the General Assembly did not take the opportunity to specify whether or not settlement expenses are covered.<sup>143</sup>

Another change according more protection to corporate personnel is the extension of the indemnification right to expenses incurred in defending claims or actions "arising out of his status" as an officer, director, employee, or agent. Previously, indemnification was limited to claims arising out of acts done in the person's capacity as an officer or director. Consequently, indemnification is now available in proper cases for third party actions.<sup>144</sup>

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indemnification. *Essential Enterprises Corp. v. Dorsey Corp.*, 40 Del. Ch. 343, 182 A.2d 647 (1962). *See also* Loftin, *Indemnification of Corporate Executives*, 1 LIABILITIES OF CORPORATE OFFICES AND DIRECTORS 69 (1968).

<sup>143</sup>Some statutes specifically refer to settlements. *See* HENN § 380, at 811 nn.46-49. It is possible that settlements would be included as an expense "reasonably incurred" in defending a claim, HENN § 380, at 812. They might also be covered in a provision of the articles of incorporation, or the bylaws or otherwise as authorized by the nonexclusive proviso of IND. CODE § 23-1-2-2(9) (1971).

<sup>144</sup>*Cf.* *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), in which the liability arose because the defendants were insiders, not because they were acting as officers or directors. *See* 1 ABA-ALI MODEL BUS. CORP. ACT ANN. § 5, at 219-20 (1971); Knepper, *Corporate Indemnification and Liability Insurance for Corporate Officers and Directors*, 25 SW. L.J. 240 (1971). However, it is unlikely that the defendants in *Texas Gulf Sulphur* would have been entitled to indemnification under the new Indiana statutory provision since they were deemed to have violated their duty to the corporation in using information that properly should have been used only for corporate purposes. *See* *SEC v. Texas Gulf Sulphur Co.*, 446 F.2d 1301 (2d Cir. 1971); *Diamond v. Oreamuno*, 23 N.Y.2d 494, 248 N.E.2d 910 (1969).

The Indiana statute in this respect is not as generous as some, including the Model Act,<sup>145</sup> in that it permits indemnification "except in relation to matters as to which he is adjudged in such action, suit or proceeding, civil or criminal, to be liable for negligence or misconduct in the performance of duty to the corporation."<sup>146</sup>

The approach of the drafters of the Model Act is to permit indemnification of persons who have not been completely successful in their defenses if they have at least met prescribed standards. Typically the person entitled to indemnification must have "acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the corporation, and with respect to any criminal action or proceeding, had no reasonable cause to believe his conduct was unlawful."<sup>147</sup> To prohibit wrongdoing directors from attempting to indemnify themselves for the expenses of their unsuccessful defenses, it is crucially important that there be an independent determination that indemnification is proper. The statutes have adopted several techniques to accomplish this, including advice of independent legal counsel, ratification by disinterested directors or the shareholders of the corporation, or order of the court hearing a derivative action.<sup>148</sup>

Separate and apart from the expansion of the corporate power to indemnify officers, directors and employees, Indiana Public Laws 244 and 271 added a new subsection to the general powers provisions of the General Corporation Act<sup>149</sup> and the Insurance Law<sup>150</sup> clearly authorizing the purchase by the corporation of liability insurance for corporate personnel. Although the *indemnification* provisions of the two Acts are not as liberal or as favorable to management as the indemnification provision of the Model Busi-

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<sup>145</sup>1 ABA-ALI MODEL BUS. CORP. ACT ANN. § 5, at 224-37 (1971); HENN § 380.

<sup>146</sup>See note 25 *supra*.

<sup>147</sup>1 ABA-ALI MODEL BUS. CORP. ACT ANN. §§ 5(a)-(b), at 224 (1971). See generally HENN § 380, at 809-11. In this respect the business judgment rule has afforded a great deal of protection against liability for errors in conduct. See *Freeman v. Hare & Chase, Inc.*, 16 Del. Ch. 207, 142 A. 793 (1928); Symposium, *Officers' and Directors' Responsibilities and Liabilities*, 27 BUS. LAW. 1, 130 (1972).

<sup>148</sup>For the jurisdictions adopting the various techniques, see 1 ABA-ALI MODEL BUS. CORP. ACT ANN. § 5, at 231-35 (1971); HENN § 380, at 810 n.38.

<sup>149</sup>IND. CODE § 23-1-2-2(10) (1971).

<sup>150</sup>*Id.* § 27-1-7-2(9).

ness Corporation Act, the newly adopted *insurance* provisions are identical to the Model Act.<sup>151</sup>

In clearly allowing for liability insurance, Indiana joins a growing list of jurisdictions recognizing that the corporation's right or power to indemnify personnel for expenses of defending actions arising out of their corporate status might not adequately protect their interests.<sup>152</sup> Director and officer, commonly "D & O," insurance does afford this added protection. Although the former indemnification provision of the General Corporation Act did not refer to liability insurance, the purchase of such insurance was probably permitted in implementing the right to indemnification, at least to the extent indemnification was permitted, or under the inherent power of a corporation to compensate corporate personnel.<sup>153</sup>

The intriguing aspect of the insurance provision is that it clearly authorizes the purchase of insurance covering liability that could not be indemnified by the corporation itself. Consequently, the issue is raised whether or not insurance can be purchased by the corporation which has the effect of freeing corporate personnel from the fear of civil liability for breaching their duty to show good faith in dealings with the corporation.<sup>154</sup> Although the language of the provision does seem to raise that possibility, it is not unlikely that public policy would preclude insuring against gross negligence, self-dealing, or conduct amounting to total abdication of corporate responsibility. A more appropriate interpretation of the new section would be to limit insurance to situations involving, for example, ordinary negligence in the performance of a duty to the corporation. Such liability would bar indemnification by the corporation but since it does not amount to grave wrongdoing, there is no more harm to the public interest than is caused by automobile liability insurance.<sup>155</sup> In this respect it should be noted that the Securities and Exchange Commission has been particularly hostile to indemnification and insurance for liabi-

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<sup>151</sup>1 ABA-ALI MODEL BUS. CORP. ACT ANN. § 5(g) (1971).

<sup>152</sup>HENN § 380, at 812; Knepper, *supra* note 35.

<sup>153</sup>Note, *Liability Insurance for Corporate Executives*, 80 HARV. L. REV. 648 (1966).

<sup>154</sup>See Bishop, *Sitting Ducks and Decoy Ducks; New Trends in the Indemnification of Corporate Directors and Officers*, 77 YALE L.J. 1078, 1087 (1968); Note, *Public Policy and Directors' Liability Insurance*, 67 COLUM. L. REV. 716 (1967).

<sup>155</sup>See note 42 *supra*.



lity arising under the Securities Act of 1933<sup>156</sup> and has severely restricted the indemnification of officers, directors, and controlling persons.<sup>157</sup> This hostility does not appear to bar all indemnification or insurance under the Securities Act but clearly does bar any indemnification or insurance defeating the objectives of statutory liability under sections 11 and 12 of the Act.<sup>158</sup>

Of course, authorization to purchase insurance covering even total breaches of corporate responsibility does not guarantee finding an insurance company ready and willing to insure against such risks. As Professor Bishop points out, the existence of such insurance might well increase the risks insured against,<sup>159</sup> and insurers are not inclined to develop or retain insurance policies that have that result. Thus the self-interest of insurance companies would insure that "D & O" insurance would not be counterproductive.

### 5. Professional Corporations—Officers

A serious obstacle to the development of solely-owned professional corporations in Indiana was eliminated by the simple expedient of amending the shareholder qualification provisions of the General Professional Corporation Act,<sup>160</sup> the Professional Medi-

<sup>156</sup>15 U.S.C. §§ 77a-aa (1970).

<sup>157</sup>17 C.F.R. § 230.460, Note (a) (1972). See Kroll, *Some Reflections on Indemnification Provisions and S.E.C. Liability Insurance in the Light of Barchris and Globus*, 24 BUS. LAW. 681, 687-92 (1969).

<sup>158</sup>15 U.S.C. §§ 77k, 1 (1970). See Kroll, *supra* note 157, at 691-92.

<sup>159</sup>Bishop, *supra* note 42, at 1094. For a discussion of the terms of a typical D & O policy and an evaluation checklist, see Hinsey & DeLancey, *Directors and Officers Liability Insurance—An Approach to its Evaluation and a Checklist*, 23 BUS. LAW. 869 (1968).

<sup>160</sup>IND. CODE §§ 23-1-13-1 to -11 (1971), as amended Ind. Pub. L. No. 246 (April 9, 1973). Although there are other benefits resulting from the incorporation of a professional practice, such as unlimited duration and limited liability, the prime motivation for utilizing the corporate form has been to enjoy the tax benefits available to corporations and their employees which traditionally have been unavailable to sole proprietors and members of partnerships. See generally HENN § 77. The legal periodicals are replete with articles discussing the tax considerations for incorporation. See, e.g., Levenfeld, *Professional Corporations and Associations*, 8 HOUSTON L. REV. 47 (1970); Overbeck, *Current Status of Professional Associations and Professional Corporations*, 23 BUS. LAW. 1203 (1968); Weinberg, *A Brief Look at the Advantages and Disadvantages of Professional Corporations*, 6 CREIGHTON L. REV. 17 (1973); *Incorporating a Private Practice—A Complete Checklist*, 16 PRAC. LAW., May 1970, at 69. Of course, it should be noted that the liberalization of benefits available for self-employed persons under the Keogh

cal Corporation Act,<sup>161</sup> and the Professional Dental Corporation Act<sup>162</sup> to permit the same person to serve as both president and secretary.<sup>163</sup> The problem can be traced back to the adoption of the Professional Medical Corporation Act in 1963 and the General Professional and Professional Dental Corporation Acts in 1965. Recognizing the inefficiency of restating the formalities required for organizing corporations and the provisions relating to the general powers, privileges, duties, or liabilities of domestic corporations under the Indiana General Corporation Act,<sup>164</sup> the General Assembly simply incorporated them by reference except when inconsistent with the specific provisions and purposes of the professional corporation acts.<sup>165</sup>

One of the provisions incorporated by reference was Indiana Code section 23-1-2-13 relating to the election of officers of general corporations and their duties and responsibilities. This section provides that when the bylaws of the corporation permit, "two or more offices may be held by the same person, except that the duties of the president and secretary shall not be performed by the same person."<sup>166</sup> Since many corporate documents or instruments must be acknowledged or verified by two officers, it does make sense to have different persons serving as the chief executive officer and the ministerial officer whose primary function is

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Act, 26 U.S.C. §§ 401-04 (1970), has somewhat reduced the drive towards professional incorporation.

<sup>161</sup>IND. CODE §§ 23-1-14-1 to -21 (1971).

<sup>162</sup>*Id.* §§ 23-1-15-1 to -21.

<sup>163</sup>The pertinent sections, in the order mentioned, are *id.* §§ 23-1-12-1 to -6, -13-4.

<sup>164</sup>*Id.* §§ 23-1-1-1 to -10-6, -12-1 to 6.

<sup>165</sup>*Id.* §§ 23-1-14-5 (medical), -15-5 (dental). A slightly different approach was used for the General Professional Act. Instead of referring to the General Corporation Act, section 23-1-13-11 incorporates the provision of the Medical Professional Corporation Act which in turn relates to the General Corporation Act. Such an incorporation by double reference would not normally make sense, but it should be pointed out that section 23-1-13-11 also incorporates other provisions of the Medical Professional Corporation Act, for example, those relating to limitation of purposes (§ 23-1-14-6) the necessity for a certificate of registration (§ 23-1-14-8) and renewal thereof (§ 23-1-14-9), the limitation on issuance and transfer of shares (§ 23-1-14-10).

<sup>166</sup>This is not an uncommon restriction in corporation statutes. See 1 ABA-ALI MODEL BUS. CORP. ACT ANN. § 5, at 91-4 (1971); HENN § 270 at 434, n.7.

to certify copies of corporate records and to keep and attest the corporate seal.<sup>167</sup> This requirement does not create any difficulty for general corporations even when there is only one shareholder and, as permitted by the General Corporation Act in such situations, one director.<sup>168</sup> A spouse, a family member, an employee, or the attorney for the corporation can always serve as the secretary.

However, the professional corporation situation was complicated by the requirement of the three Acts that only individuals holding unlimited licenses to practice the relevant profession could be officers, directors, or shareholders of professional corporations.<sup>169</sup> Thus the sole practitioner wishing to incorporate was forced to find another licensed professional to serve as the secretary of the corporation. Finding someone willing to undertake this responsibility for another practitioner might be difficult even in a sizable metropolitan area, but doubtless it would be impossible in small communities where there might be only one doctor, lawyer, or dentist. Certainly there was no legislative intent to limit professional corporations to what were, or would be in the absence of the statutes, partnerships. To the contrary, all three Acts provide that "an individual" can organize and become a shareholder of a professional corporation.<sup>170</sup>

New legislation<sup>171</sup> eliminated the difficulty by eliminating the restriction. In so doing, Indiana joins those jurisdictions which have resolved the problem of the solely-owned professional corporation by eliminating the restriction against the same person's serving in two capacities<sup>172</sup> or by eliminating the requirement that certain officers be licensed professionals.<sup>173</sup> It is possible that the enactment was not really necessary. All three professional corporation acts provide that the General Corporation Act provisions

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<sup>167</sup>*Citizens' Dev. Co. v. Kypawva Oil Co.*, 191 Ky. 183, 229 S.W. 88 (1921); HENN § 225, at 434 n.7; LATTIN § 75.

<sup>168</sup>IND. CODE § 23-1-2-11(b) (1971) provides that the number of directors shall not be less than three unless there are only one or two shareholders when, respectively, one or two directors are permitted.

<sup>169</sup>*Id.* §§ 23-1-13-6 (general), -14-12 (medical), -15-12 (dental).

<sup>170</sup>*Id.* §§ 23-1-13-6 (general), -14-4 (medical), -15-4 (dental).

<sup>171</sup>Ind. Pub. L. No. 246 (April 19, 1973).

<sup>172</sup>*E.g.*, TEX. REV. CIV. STAT. ANN. art. 1528f, § 9(g) (Cum. Supp. 1972) (any one person may serve in more than one office, provided that the president and secretary are not the same person unless the professional association has only one member).

apply "except where inconsistent with the provisions and purpose of this Act," and that the professional corporation act "shall take precedence in the event of any conflict with the Indiana General Corporation Act."<sup>174</sup> Since the professional corporation acts contemplate sole ownership and require that all officers be licensed professionals, it is not inconceivable that a court would rule that the General Corporation Act was impliedly amended to permit one person to hold the offices of president and secretary when there is no other eligible person involved in the corporation.<sup>175</sup>

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<sup>173</sup>*E.g.*, ALA. CODE tit. 46 § 336 (Cum. Supp. 1971); GA. CODE ANN. § 84-5404(c) (Supp. 1972); S.C. CODE ANN. § 56-1606 (Supp. 1971).

<sup>174</sup>IND. CODE §§ 23-1-13-11 (general), -14-5 (medical), -15-5 (dental) (1971).

<sup>175</sup>*Cf.* Christian v. Skideler, 382 P.2d 129 (Okla. 1963), in which the court held that the three director requirement of the Oklahoma general corporation law did not apply when only two persons were incorporating and a third qualified director might not be available.

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## VI. CRIMINAL PROCEDURE

*William A. Kerr\**

On January 1, 1972, the Indiana Court of Appeals acquired jurisdiction over criminal appeals, thus marking a major change in Indiana criminal procedure.<sup>1</sup> Under the new procedure, the court of appeals has jurisdiction over all criminal appeals except for a limited number of cases over which the Indiana Supreme Court has retained exclusive jurisdiction such as appeals from judgments imposing a sentence of death, life imprisonment, or a minimum sentence of greater than ten years, and appeals involving cases in which a state or federal statute has been declared unconstitutional in whole or in part.<sup>2</sup> Since there are only a few offenses

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<sup>1</sup>*See* IND. R. APP. P. 4 (adopted by the Indiana Supreme Court pursuant to Ind. Code § 33-2.1-3-1 (1971) and the amendment to article 7 of the Indiana Constitution which was approved on November 3, 1970).

<sup>2</sup>IND. R. APP. P. 4(A) (7)-(8), (B).