Recent Developments in Corporation Law

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Introduction

Nineteen ninety-two was a relatively quiet year for corporation[1] law developments in Indiana. After several years of intensive legislative activity, the Indiana General Assembly and Indiana courts took the opportunity to make a few corrections to existing corporation statutes and to refine established common law doctrine. The purpose of this Article is to summarize those developments and to highlight certain changes anticipated as a result of renewed legislative activity in 1993, *i.e.* the introduction of legislation permitting the formation of limited liability companies.

This Article first addresses the limited statutory changes that occurred in 1992. It then discusses cases decided by the Indiana Court of Appeals and the Indiana Tax Court on such topics as piercing the corporate veil, shareholder relations in closely held corporations, nonprofit corporations, and interpretations of the Indiana Business Corporation Law (BCL).[2] Finally, this Article briefly notes the enactment of the Indiana Business Flexibility Act,[3] which will permit the formation of limited liability companies in Indiana.

I. Statutory Developments

After a series of significant legislative efforts resulting in the introduction, adoption, and amendment of the BCL and the Indiana Nonprofit Corporation Act of 1991 (1991 Act), there were few changes in cor-

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1. This Article covers laws governing business corporations, including for-profit, not-for-profit, professional, and closely held varieties. It does not cover business trusts, boards of trade, exchanges, and chambers of commerce under Ind. Code § 23-5-1 (1992); public corporations and associations such as the Indiana Historical Society under § 23-6-2 or the Indiana Business Development Credit Corporation Law under § 23-6-4; fraternal organizations under § 23-10-2; or educational institutions such as Vincennes University under § 23-13-18, Wabash College under § 23-13-19, and the University of Evansville under § 23-13-20; or cemetery associations under § 23-14.

2. Ind. Code §§ 23-1-17-1 to -1-54-3 (1988 & Supp. 1992).

3. Pub. L. No. 8-1993, 108th Gen. Assembly, 1st Reg. Sess. (1993) (adding Ind. Code §§ 23-18-1-1 to -13-1).

poration statutory law in 1992. The Indiana General Assembly did not change the BCL, the Professional Corporations Act,[4] or the laws governing takeover offers. The only amendments of the 1991 Act were in the nature of technical corrections principally intended to clarify or correct certain cross-references to other code provisions or to other sections of the 1991 Act, or to conform the language to typical statutory form.[5]

However, other amendments to the Indiana Code related to the 1991 Act merit a brief review. In adopting the 1991 Act, the Indiana General Assembly inadvertently approved blanket changes to certain statutes governing specialized corporations, such as those formed for the purpose of distributing water, those established as community development corporations or mutual housing associations, and those operated as public utilities,[6] which brought into question their corporate status and authority to operate without reincorporating under the 1991 Act. The amendments adopted under Public Law 1-1992 in conjunction with specific amendments to the 1991 Act corrected that inadvertent and unintentional result.

II. Case Law

In 1992, Indiana courts considered relatively few cases raising issues about corporate governance and regulation. Of eleven cases involving corporation law considered by the Indiana Court of Appeals and the Tax Court of Indiana, four focused on the circumstances under which it was appropriate to "pierce the corporate veil," three dealt with governance of closely held corporations, one addressed corporate governance issues in the context of a nonprofit corporation, and three interpreted provisions of the BCL dealing with notice of meetings, the standard of conduct imposed upon directors, and agency law as it applies to corporate officers and employees. With one exception, these cases did not break any new ground, but merely acted to confirm existing common law and statutory principles. A synthesis of these cases is presented below.

A. Piercing the Corporate Veil

In four cases, the Indiana Court of Appeals and the Tax Court of Indiana explored and reconfirmed the parameters of separate corporate

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4. Ind. Code § 23-1.5-1-1 to -14 (1988) (governing corporations formed by accounting professionals, architectural or engineering professionals, attorneys, health care professionals, and veterinarians).

5. Act of Feb. 12, 1992, Pub. L. 1-1992, §§ 118-128, 1992 Ind. Acts 1, 95-105 (codified as amended Ind. Code §§ 23-17-12-9, -17-2, -17-4, -17-5, -17-7 to -10, -18-1, -19-3, -20-2).

6. Act of Feb. 12, 1992, Pub. L. 1-1992, § 7, 1992 Ind. Acts 1, 5-6 (codified as amended Ind. Code § 4-4-12-1); § 12, 1992 Ind. Acts 1, 16 (codified as amended Ind. Code § 5-20-3-4); § 29, 1992 Ind. Acts 1, 30-32 (codified at amended Ind. Code § 8-1-2.2-2(h)).

existence. The context for these discussions was best addressed by the Tax Court in *SFN Shareholders Grantor Trust v. Indiana Department of State Revenue*,[7] which began its analysis by stating that "[o]ne of the hallmarks of Anglo-American corporate law is the status of the corporation as a distinct entity, an artificial person separate from its shareholders, having the capacity to own property and to sue and be sued."[8] The Tax Court also noted that the doctrine of separate corporate existence cannot be defeated merely because a corporation also is a subsidiary, even a wholly owned subsidiary, of another corporation.[9] In considering this issue in *Gurnik v. Lee*,[10] the Indiana Court of Appeals for the Second District recited the fundamental proposition that Indiana courts, while reluctant to disregard corporate form, nevertheless "will do so to protect innocent third parties from fraud or injustice."[11] The court noted, however, that the party seeking to pierce the corporate veil has the burden of proof and must show that the corporate form "was so ignored, controlled or manipulated that it was merely the instrumentality of another, and that the misuse of the corporate form would constitute a fraud or promote injustice."[12] In *Detrick v. Midwest Pipe & Steel, Inc.*,[13] the Indiana Court of Appeals for the Third District enunciated a similar statement of the law, adding that the corporate veil may be pierced where "innocent third parties have no way of knowing with which entity they are dealing."[14]

In determining whether it is appropriate to pierce the corporate veil, the court must review carefully the entire relationship between the corporate entities and their respective directors, officers, and shareholders.[15] In 1992, the courts considered a variety of factors in assessing these relationships, which are delineated below in the context of the cases in which they were decided.

In *Gurnik*, the Court of Appeals addressed a plaintiff's request that

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7. 603 N.E.2d 194 (Ind. Tax Ct. 1992).

8. *Id.* at 197-98.

9. *Id.* at 198.

10. 587 N.E.2d 706 (Ind. Ct. App. 1992).

11. *Id.* at 710 (citing Stacey-Rand, Inc. v. J.J. Holman, Inc., 527 N.E.2d 726, 728 (Ind. Ct. App. 1988); State v. McKinney, 508 N.E.2d 1319, 1320 (Ind. Ct. App. 1987); Extra Energy Coal Co. v. Diamond Energy & Resources, Inc., 467 N.E.2d 439, 441 (Ind. Ct. App. 1984)).

12. *Id.* (relying on federal opinions for burden allocation as indicated by citation to Chicago Florsheim Shoe Store Co. v. Cluett, Peabody & Co., 826 F.2d 725, 728 (7th Cir. 1987); Orloff v. Allman, 819 F.2d 904, 908-09 (9th Cir. 1987); United States v. Van Diviner, 822 F.2d 960, 965 (10th Cir. 1987)).

13. 598 N.E.2d 1074 (Ind. Ct. App. 1992).

14. *Id.* at 1080.

15. *Id.*

the corporate form of The Travel Trade, Inc. be disregarded and that judgment on her claim for payment of unpaid wages be entered against its principal shareholder (M. Monroe Lee) or a corporation he controlled. Lee had agreed to provide working capital for Travel and did so through a series of loans between corporations he controlled and Travel. Plaintiff Jo Lynn Dickinson was the former president of Travel, who brought an action seeking payment of a bonus for the last year during which she was employed by Travel.[16] The court first held that the trial court had erred in holding that Dickinson did not have a valid claim for unpaid wages, and then addressed the question of whether judgment on that claim could be entered against Lee or The Lee Corp., of which Lee was the sole shareholder.[17]

The court carefully identified several factors important in determining whether to pierce the corporate veil, but noted that no one factor alone is enough. Dickinson's primary argument in favor of piercing the corporate veil was that both Lee and The Lee Corp. loaned Travel substantial funds as working capital and that proceeds from the liquidation of Travel's assets were distributed to Lee and/or The Lee Corp. The court found this argument unpersuasive, concluding that the mere existence of a loan or series of loans between related corporations did not justify piercing the corporate veil.[18]

In its analysis, the court considered the following factors important: First, there was no evidence that Travel was used as the alter ego of its principal shareholder, Lee. Second, corporate formalities were consistently maintained in that each of the corporations held separate board meetings, kept regular records of those meetings, maintained separate bank accounts and accounting records, and filed separate tax returns. The loans between Travel and The Lee Corp. were properly and separately recorded in the accounting records of each corporation.[19]

In *Cap Gemini America, Inc. v. Judd*,[20] the Court of Appeals for the First District was faced with the question of whether evidence of the wealth of a parent corporation could be considered in assessing punitive damages against one of its subsidiaries. In this case, Cap Gemini America (a wholly owned subsidiary of Cap Gemini Sogeti) brought an action against Roy A. Judd, a former employee, for breach of covenants not to solicit employees, interference with contractual relationships, breach of fiduciary duty of loyalty, and unfair competition. Judd counterclaimed to recover unpaid wages, breach of resignation agreements, wrongful

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16. *Gurnik*, 587 N.E.2d at 707.
17. *Id.* at 707-10.
18. *Id.* at 710-11.
19. *Id.*
20. 597 N.E.2d 1272 (Ind. Ct. App. 1992).

discharge, fraud, and other related claims.[21] At trial, Judd attempted to fix the amount of punitive damages to which he claimed he was entitled by reference to the financial records and position of Cap Gemini Sogeti, the parent corporation. The court held that Judd failed to meet his burden of proof, noting that he had not argued that Cap Gemini America was a mere instrumentality of Cap Gemini Sogeti, and stating that "corporate form will not be disregarded solely because a corporation is the parent of another."[22] The court concluded that "[w]here no showing is made that the corporate veil should be pierced because the subsidiary was simply an alter ego or mere instrument of the parent, the wealth of the parent corporation cannot be considered for any purpose."[23]

Important to the trial court in *Detrick*, a wrongful death action, were the undisputed facts that Midwest Pipe & Steel, Inc. (a steel distributor who was shipping cargo through Midwest Trucking, Inc.) had no "interest" in Midwest Trucking, Inc., the employer of the individual who caused the accident leading to the wrongful death claim. "No identity" of shareholders, directors, or officers existed, and the corporations were formed at different times for different purposes. Each corporation had separate officers, separate telephone numbers, separate bank accounts, and separate books of account. Funds of the two corporations were not commingled.[24] The court of appeals concurred with the trial court's basic analysis of the corporate veil issue, but concluded that upon retrial the plaintiff might be able to establish exceptional circumstances justifying piercing the corporate veil through resolution of certain factual disputes not resolved at the trial court level. The principal factual dispute centered on whether two individuals (one of whom owned Midwest Trucking and the other of whom owned Midwest Pipe) had "agreed that Midwest Trucking would be incorporated for the sole purpose of hauling Midwest Pipe product, would be identified as a 'Midwest' carrier to the motoring public, and identified as a 'Midwest Pipe' carrier to customers" and officials of the Department of Transportation.[25]

In *SFN Shareholders Grantor Trust*, the Tax Court of Indiana held that the doctrine of separate corporate identity does not break down merely because one corporation is the subsidiary of another.[26] The court

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21. *Id.* at 1277-78.
22. *Id.* at 1286.
23. *Id.*
24. Derrick v. Midwest Pipe & Steel, Inc., 598 N.E.2d 1074, 1080 (Ind. Ct. App. 1992).
25. *Id.* at 1081.
26. SFN Shareholders Granter Trust v. Indiana Dep't of State Revenue, 603 N.E.2d 194, 198 (Ind. Tax Ct. 1992).

refused to disregard corporate form, even though there was a close corporate relationship between the parent and subsidiary corporations in this case. The court held that ownership of the capital stock of a subsidiary did not amount to ownership of its assets and the court refused to permit the Indiana Department of State Revenue to assess gross income tax on the sale by the parent of the capital stock of its subsidiary. The court did note that the parent and subsidiary corporations had certain directors in common, but also noted they had different business locations.[27] In addition, they had different corporate purposes, the parent corporation was a holding company engaged primarily in holding all the shares of sixteen different corporations and the subsidiary was a publisher, principally of educational text books.[28]

These four cases emphasize the need for careful pleading and proffer of evidence at trial: The party seeking to pierce the corporate veil must allege that the corporation was simply an alter ego or mere instrumentality of the shareholder (including any parent corporation). In addition, it is clear that a parent-subsidiary corporation relationship alone will not justify piercing the corporation veil, as one must be prepared to show an intermingling of purposes, operations, governance, accounting records, or financial arrangements.

These cases also remind practitioners who advise corporate clients of the importance of observing *all* corporate formalities and operating related corporations as if unrelated. Separate meetings of directors and officers should be held, separate accounting records should be maintained, separate banking arrangements should be established, and separate physical facilities and locations should be encouraged.

B. Closely Held Corporations

Three decisions rendered by the Indiana Court of Appeals in 1992 addressed the relationships among shareholders of closely held corporations as to corporate governance and the valuation of minority shareholder interests. In *Lowry v. Lowry*,[29] minority shareholders of a closely held corporation engaged in farming brought an action against the corporation's directors (their parents) alleging misuse of corporate funds, excessive compensation, waste of corporate assets, and mismanagement. Evidence at trial showed egregious conduct: The father and stepmother of the plaintiffs had falsified information on their personal tax returns, executed a mortgage on the corporation's property to assist the step-

27. *Id.* at 198-99.
28. *Id.* at 196.
29. 590 N.E.2d 612 (Ind. Ct. App. 1992).

mother's son purchase of a business, executed a mortgage to secure their own personal indebtedness, refused to provide corporate financial information when the minority shareholders so requested, amended the Articles of Incorporation without the minority shareholders' knowledge or approval, and received salaries far in excess of those set forth in the corporate minutes book.[30]

In accordance with existing law, the court imposed upon the plaintiffs the burden of establishing unreasonable compensation, readily finding that burden satisfied.[31] In addition, the court held that the defendants had "violated the fiduciary duty of directors and shareholders within a close corporation to operate fairly, honestly, and openly" by regarding and dealing with the assets of the corporation as if they were their personal assets.[32] In support of this result, the court recited the facts that defendants took excessive salaries, falsified tax returns and articles of incorporation, and "drained the corporation's assets without regard to corporate liabilities thereby allowing the corporation to default on corporate obligations."[33]

Further, because the defendants had breached their fiduciary duty to deal openly, honestly, and fairly with the minority shareholders, the court of appeals affirmed the trial court's holding that the defendants were not entitled to the statutory protection of Indiana Code section 23-1-35-1, which permits directors to avoid "personal liability if they act in good faith, 'with the care an ordinarily prudent person in a like position would exercise under similar circumstances,' and in a manner reasonably believed to be in the best interest of the corporation."[34] The court accurately stated the duty of care applicable to directors under section 23-1-35-1(a) of the BCL, but erred in further stating that a breach of this duty results in personal liability. Rather, section 23-1-35-1(e) imposes liability only if a breach of or failure to perform director's duties occurs *and* "[t]he breach or failure to perform constitutes willful misconduct or recklessness."[35] The court did not note this important distinction and thus did not address the question of whether the defendant's conduct rose to the level of willful misconduct or recklessness.

The court noted that the law presumes directors who breach their fiduciary duties to the corporation and minority shareholders engage in fraud. Accordingly, this presumption shifted the burden of proof to the defendants to show that their actions were honest and in good faith. The court readily concluded that the defendants failed to carry this

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30. *Id.* at 615-16.
31. *Id.* at 621-22.
32. *Id.* at 620.
33. *Id.*
34. *Id.* at 622 (interpreting IND. CODE § 23-1-35-1(a) & (e)).
35. IND. CODE § 23-1-35-1(e) (1988).

burden of proof, holding that the conduct in which they had engaged amounted to fraud.[36]

The two other cases involving closely held corporations focused on the valuation of minority shareholder interests in the context of the sale of their shares. In *Battershell v. Prestwick Sales, Inc.*,[37] the Court of Appeals for the First District considered a dispute among shareholders of a corporation involved in a residential development and golf course. Prior to the trial, the parties entered into a court-sanctioned Agreed Entry whereby the plaintiffs agreed to sell and the defendants agreed to buy all of the plaintiffs' interests in Prestwick Sales, Inc. The Agreed Entry provided that the trial court would hear evidence on the question of the price to be paid for the plaintiffs' interests. On appeal, the plaintiffs challenged the trial court's interpretation of the Agreed Entry, claiming that the trial court should have awarded them the fair market value of their stock.[38]

The trial court had acknowledged that fair market value was the normal method of valuing equity interests in closely held corporations, but did not award plaintiffs that value. Instead, under the court's interpretation of the Agreed Entry, the parties had agreed to permit the trial court to consider "any and all issues" related to the determination of the price—including factors unrelated to fair market value. The factors that the trial court considered included the price that the plaintiffs paid for the stock, the personal risk the plaintiffs had undertaken in guarantying debt the corporation incurred, the length of time they had incurred that risk, and the plaintiffs' unwillingness to guaranty personally further loans to the corporation after December 1986. As a result, the trial court fixed the value of the stock at $247,000, not the $602,705.80 that the trial court had determined was the fair market value.[39]

The court of appeals disagreed with the trial court's interpretation of the Agreed Entry, concluding that the agreement did not clearly communicate the intent to deviate from the fair market value. The court of appeals recognized that Indiana law does not require courts to value stock solely on the basis of fair market value, noting that "parties are free to stipulate to evaluation other than fair market value. . . . When the parties do not make such a stipulation, however, we find that fair market value is the appropriate method of valuing stock."[40] The court of appeals held that trial court erred when it considered factors irrelevant

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36. *Lowry*, 590 N.E.2d at 623.
37. 585 N.E.2d 1 (Ind. Ct. App. 1992).
38. *Id.* at 2-3.
39. *Id.*
40. *Id.* at 5.

to fair market value. The court of appeals concluded that "[i]nstead of requiring parties to explicitly state that stock is to be valued solely on its fair market value, we find the better rule is to require parties who wish to deviate from that fair market value to express clearly that intent."[41]

In the second valuation case, *Hardy v. South Bend Sash & Door Co.*,[42] a shareholder in a closely held corporation sold his stock under the terms of a stock purchase agreement, and then brought an action against the purchasers for breach of that agreement. The agreement provided that prior to any transfer of the shares of the corporation, a shareholder must offer to sell his or her shares to the other shareholders for a purchase price to be determined periodically by mutual agreement of the shareholders. The initial purchase price was $2,000 per share. The agreement also required that upon the termination of a shareholder's tenure as an officer of the corporation, the shareholder was required to sell and the remaining shareholders of the corporation were required to buy all of the transferring shareholder's interest in the corporation.[43]

Several transfers of shares of the corporation occurred over the ten year period beginning with execution of the agreement and ending prior to initiation of the lawsuit. In December 1987, the plaintiff, an officer of the corporation, tendered a letter of resignation that the Board of Directors then accepted, to be effective on December 31, 1987. On April 11, 1988, meetings of the directors and shareholders of the corporation were held, at which they voted to increase the price per share payable under the agreement to $3,000. Thereafter, in May 1988, the surviving officer-shareholders notified the plaintiff of their intent to purchase his stock at a purchase price of $3,000 per share.

Following receipt of the notice, the plaintiff filed a lawsuit alleging breach of the agreement. Upon and in response to defendants' motion for summary judgment, plaintiff sought to establish four issues of material fact in order to preclude a ruling in the defendants' favor. The plaintiff alleged that the agreement did not clearly express an intent to deviate from market value as the method of valuation. He also alleged that stock sales made after December 1978 occurred without written notice to the other shareholders and that the defendants had misrepresented the corporation's true financial condition to him. The court noted that Indiana law provides that parties to stock purchase agreements are "free to use methods of valuation other than 'book value,'" adding

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41. *Id.* at 6.
42. 603 N.E.2d 895 (Ind. Ct. App. 1992).
43. *Id.* at 897.

that it is for the shareholders to determine the method of valuation not the courts.[44]

In analyzing the fiduciary duty issue, the court stated that the shareholders of a closely held corporation "stand in a fiduciary relationship and must deal openly, honestly, and fairly with one another and the corporation."[45] The court qualified this statement, however, by adding that the shareholder fiduciary duty rule "is limited when a director-shareholder buys or sells corporate stock for his own account."[46] The court expounded on this point, stating that "a corporate director who sells his personal shares or buys shares from other shareholders for his personal ownership owes no fiduciary duty to disclose information he possesses regarding the value of the stock to the other shareholders, provided that such a sale does not affect the general well-being of the corporation."[47] The court found that the facts indisputably showed that the sale of stock was between shareholders, not between the corporation and a shareholder. Therefore, the court concluded that the agreement controlled the valuation of the plaintiff's interests in the corporation, and that the purchasing shareholders did not have any duty to disclose financial information about the corporation to the plaintiff.[48] The Court of Appeals upheld the trial court's grant of summary judgment in favor of the defendants on the issues of breach of contract, fraud, constructive fraud, and conspiracy.[49]

These cases reiterate two important and all too frequently ignored principles. First, majority shareholders of a closely held business cannot operate that business and deal with its assets as if it were their personal property. Conduct in which a sole proprietor may engage with impunity may be unacceptable in the context of a corporation. Second, agreements providing for the purchase and sale of interests in closely held corporations should be carefully and clearly drafted to express the parties' intentions with respect to valuation. If fair market value (or what the BCL refers to as "fair value"[50]) is intended, the agreement should so state. If it is not, the factors to be analyzed in determining value (if a value is not provided in the agreement) should be clearly set forth in the agreement.

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44. *Id.* at 899.
45. *Id.* at 900.
46. *Id.* (citing Fleetwood Corp. v. Mirich, 404 N.E.2d 38, 46 (Ind. Ct. App. 1980)).
47. *Id.*
48. *Id.*
49. *Id.* at 903.
50. IND. CODE § 23-1-44-3 (1988) (valuation for purposes of dissenters' rights).

C. Nonprofit Corporations

In 1992, the Indiana Court of Appeals considered a case focusing on corporate governance of nonprofit corporations organized under Indiana law. In *Brenner v. Powers*,[51] the Court of Appeals for the Third District examined the membership rights of minority members of a nonprofit corporation organized under the 1935 General Not-For-Profit Corporation Act. This action was brought on behalf of several minority members of the Munster Medical Research Foundation, Inc. (MMRF) to challenge their exclusion from the voting membership of MMRF and the validity of the use of corporate funds for certain purposes.

Over the course of several decades the voting members of MMRF had amended its articles of incorporation by majority vote and these amendments had included changes in MMRF's membership provisions. In June 1985, the Board of Directors adopted another proposal for amending the Articles of Incorporation. That same day, they called a meeting of the members and adopted the amendments by a membership vote of 18 to 0. The plaintiffs alleged that they received no notice of this meeting and, therefore, were not able to exercise their right to vote.

The amendments approved at the meeting made significant changes in MMRF's membership provisions by eliminating all existing members and provided for one member, the Community Foundation, Inc., and such other members as the Foundation might select. The amendments also empowered the new members to make corporate decisions at annual or special meetings.[52]

The court commenced its analysis of whether the plaintiffs' membership rights had been usurped by the June 1985 amendment by noting that "courts will not interfere with the internal affairs of a private organization unless a personal liberty or property right is jeopardized."[53] The court cited prior decisions of the court of appeals in stating that the articles of incorporation and bylaws of a nonprofit corporation are considered to be a form of contract between the corporation and its members, as well as among the members themselves.[54] The court rejected the plaintiffs' claim that they were lifetime members of MMRF, noting

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51. 584 N.E.2d 569 (Ind. Ct. App. 1992). As the court pointed out in its first footnote in the case, the parties to the dispute relied upon the 1971 Not-For-Profit Corporation Act (1971 Act) for the authority for their arguments, but the record did not show that the corporation in question had accepted the 1971 Act, so the court followed the provisions of the 1935 Act for the purposes of rendering its decision. *Id.* at 571 n.1.

52. *Id.* at 572.

53. *Id.* at 574.

54. *Id.* (citing Lozanoski v. Sarafin, 485 N.E.2d 669, 671 (Ind. Ct. App. 1985)).

that a majority vote of the members had always been sufficient to change the membership provisions.

The court recited the general principle that the contractual relationship between a member of a nonprofit corporation and the corporation itself includes the applicable statutes under which the corporation is organized. In this case, the relevant statute provided that voting members of a nonprofit corporation were entitled to ten days advance notice of a meeting and that voting members had a right to vote on all matters affecting their membership status.[55] The court concluded that the plaintiffs were voting members at the time that the June 1985 amendment was adopted by the members of MMRF and were entitled to ten days advance notice, a right to attend, and a right to vote on the proposed amendments. Accordingly, the court held that the defendants breached their contract with the plaintiffs.

The court concluded that the former members had standing to bring a breach of contract claim based on a violation of their vested statutory rights and reversed the case for further proceedings on this issue. The court also concluded that the former members had standing to bring a declaratory judgment action to determine their individual membership rights, but they did not have standing to bring a quo warranto action.[56]

D. Indiana Business Corporation Law

The Indiana Court of Appeals considered three cases interpreting various statutes and laws governing business corporations in 1992. In a case of first impression, the court of appeals considered whether a plan of merger was invalid because the corporation failed to give timely notice under the BCL of the shareholder meeting at which vote on the plan was taken. In another case, the court of appeals considered the standard of conduct applicable to directors of a grain elevator cooperative. Finally, the court of appeals had an opportunity to address issues of agency law in the context of corporate contractual obligations.

In *Hilligoss v. Associated Companies, Inc.*,[57] the court of appeals considered the plaintiff's complaint that the corporation failed to provide timely notice of a meeting of its shareholders called for the specific purpose of considering a plan of merger. On June 22, 1989, Associated Companies mailed to Hilligoss (by first-class postage prepaid United States mail) notice of a special meeting of the shareholders to be held on July 3, 1989 along with a proxy statement. Hilligoss, then a resident of France, received the notice on June 29, 1989, and on June 30, 1989,

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55. *Id.* at 575.
56. *Id.* at 576.
57. 589 N.E.2d 1202 (Ind. Ct. App. 1992).

mailed his proxy statement dissenting from the plan of merger and sent a mailgram to the company indicating his dissent from the plan of merger.[58]

On July 3, 1989, the company held the special meeting of its shareholders and the plan of merger was approved. Several hours later, the company received the mail-gram from Hilligoss indicating his dissent. The company refused to recognize Hilligoss as having perfected his dissent, and Hilligoss' equity holding in Associated Companies was converted into shares of the Acap Corporation, the parent company of Associated Companies. In his subsequent lawsuit, the plaintiff alleged that the stock he received was worth substantially less than his interest in Associated Companies prior to the merger.[59]

The court looked to Indiana Code section 23-1-29-5(a), which provides that a corporation "shall notify shareholders of the date, time, and place of each annual and special shareholders' meeting no fewer than ten (10) nor more than sixty (60) days before the meeting date."[60] The court reviewed the record, concluding that notice of the shareholder meeting was effective on the date mailed, June 22, 1989.[61] The plaintiff, relying on Indiana Trial Rule 6(A) and Indiana Code section 34-1-61-1,[62] argued that the first day that should be considered in determining whether the statutory time frame was met was June 23, not June 22. Moreover, because the tenth day thereafter fell on a Sunday, and Sundays are excluded in this calculation, the "tenth" day for the purpose of the statute would be July 3, 1989.[63]

Closely examining the language of the statute, the court concluded that "because the statute requires that *notice be provided* no fewer than ten (10) days before the meeting date, days should be counted 'backwards'

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58. *Id.* at 1203.

59. *Id.*

60. IND. CODE § 23-1-29-5(a) (1988).

61. *Hilligoss*, 589 N.E.2d at 1204. The court also noted that the corporation is obligated to mail notice only to the last known address of the shareholder as shown in the corporation's current records. Evidently, however, the plaintiff did not raise as an issue the address to which his notice was mailed as the court does not mention this statutory provision after its one passing reference and the holding does not turn upon interpretation of that section. *Id.*

62. Indiana Trial Rule 6(A) provides that: "In computing any period of time prescribed or allowed . . . by any applicable statute, the day of the act, event, or default from which the designated period of time begins to run shall not be included. The last day of the period so computed is to be included unless it is: . . . (2) a Sunday . . . . In any event, the period runs until the end of the next day that is not a . . . Sunday . . . ." Indiana Code § 34-1-61-1 (1992) provides that: "The time within which an act is to be done, as herein provided, shall be computed by excluding the first day and including the last. If the last day be Sunday, it shall be excluded."

63. *Hilligross*, 589 N.E.2d at 1204-05.

from the date of the meeting to the date notice is effective and not 'forwards' from the date that notice is provided to the meeting date.''[64] Under this test, the court found it obvious that notice was provided in a timely manner and affirmed the trial court's grant of summary judgment in favor of Associated Companies.[65]

Brane v. Roth[66] presented the Court of Appeals for the First District with a shareholders' action against the directors of a rural grain elevator cooperative for losses the cooperative suffered due to the directors' failure to protect its financial position by hedging adequately in the grain market. The cooperative's financial records showed a steady pattern of losses, and after a particularly large loss in 1979, the directors of the cooperative authorized the manager to hedge its position in the market. Only a minimal amount was ever hedged in the following years, and in 1980 the cooperative's certified public accountant made substantial errors in the cooperative's 1980 financial statements, which when discovered in 1982 revealed that his report of a $68,683 net profit was really a $424,038 loss. The certified public accountant who reviewed and corrected the original financial statement opined at trial that the primary cause of the loss was the failure to hedge.[67]

The trial court entered specific findings that the directors had breached their duties by retaining a manager inexperienced in hedging and by failing to supervise him properly. On appeal, the directors argued that the trial court had erred in applying the standard of care set forth in Indiana Code section 23-1-2-11,[68] which was repealed in 1986 and replaced with section 23-1-35-1(e).[69] The court refused to retroactively apply the standard of care established in Indiana Code 23-1-35-1(e), stating that ''retroactive application is disfavored when existing rights would be infringed. . . . Because I.C. § 23-1-35-1 narrows director liability, the statute effects existing rights shareholders had against directors.''[70]

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64. *Id.* at 1205 (emphasis added).

65. *Id.* at 1205.

66. 590 N.E.2d 587 (Ind. Ct. App. 1992).

67. *Id.* at 589.

68. Indiana Code § 23-1-2-11 (repealed 1986) ''provided that a director shall perform his duties in good faith in the best interest of the corporation and with such care as an ordinarily prudent person in a like position would use in similar circumstances.'' *Brane*, 579 N.E.2d at 590. Furthermore, directors were permitted to rely upon information, reports, and opinions of the corporation's officers and employees to the extent that the directors believed them to be reliable and competent. *Id.*

69. Indiana Code § 23-1-35-1 ''preserved the former standard of care but narrowed liability by adding that a director is not liable unless he has breached or failed to perform his duties and such breach or failure to perform constitutes willful misconduct or recklessness.'' *Brane*, 590 N.E.2d at 590.

70. *Brane*, 590 N.E.2d at 590.

In finding that the trial court applied the correct standard of care, the court of appeals also examined the business judgment rule as it applied to the directors' actions. The court noted that the business judgment rule protects directors from liability, but only if their decisions are informed ones.[71] In an earlier case, the court held that a director could not act blindly and then avoid the consequences by claiming he or she was not aware of the effect of that action. The court in the earlier case further recited that directors have a duty to become informed about the actions that they undertake.[72] In *Brane*, the court held that "the evidence shows that the directors made no meaningful attempt to be informed of the hedging activities and their effects upon [the cooperative's] financial position. Their failure to provide adequate supervision of the manager's actions was a breach of their duty of care to protect [the cooperative's] interests in a reasonable manner."[73]

In a cross between agency law and corporation law, *Blairex Laboratories, Inc. v. Clobes*[74] provided the court of appeals for the First District with the opportunity to expound upon the doctrines of express and implied authority as they apply to a corporation's agents. Clobes, a pharmacist, developed a sterile saline solution for use in inhalation therapy and entered into a royalty agreement with Blairex Laboratories, Inc. to produce and market the product. The Board of Directors of Blairex held a special meeting in December 1986 at which it directed the president of Blairex to enter into a royalty agreement with Clobes, and through a series of offers and counter-offers, the president and Clobes agreed that Blairex would pay Clobes a royalty of 3.5% on this product and 5% on another product Clobes had suggested. Attorneys for Blairex prepared the written agreement, which was revised twice thereafter, and finally signed in May 1987. Blairex made regular royalty payments to Clobes even after he left their employ in April 1988. After the last quarter of 1988, no further royalty payments were made and Clobes sued Blairex. The trial court entered judgment in Clobes' favor and Blairex appealed.[75]

The court reviewed existing Indiana common law on the doctrines of express and implied authority, noting that express authority may be derived from the charter or bylaws of the corporation, resolutions of its board of directors, and other written authorizations such as memoranda and letters. Implied authority binds a corporation only if the

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71. *Id.* at 591-92.

72. *Id.* at 592 (citing W & W Equip. Co. v. Mink, 568 N.E.2d 564, 575 (Ind. Ct. App. 1991)).

73. *Id.*

74. 599 N.E.2d 233 (Ind. Ct. App. 1992).

75. *Id.* at 234-35.

act is appropriate in the ordinary course of the corporation's business, and may arise from a course of conduct whereby the corporation has repeatedly ratified acts of the same type.[76] The court carefully distinguished apparent authority from the forgoing, noting that apparent authority is created when a third person has reason to believe, as a result of some action on the part of the corporation, that the corporation has given the agent authority to act.[77]

The court addressed the question of whether the president had authority to bind Blairex to the royalty agreement by first examining Indiana Code section 23-1-36-2 and then addressing Blairex's bylaws (which provided that the president was responsible for signing all of Blairex's contracts unless the Board of Directors stated otherwise) and actions of the board of directors. The BCL defines the powers and duties of corporate officers by providing that:

> Each officer has the authority and shall perform the duties set forth in the bylaws or, to the extent consistent with the bylaws, the duties prescribed by the board of directors or by direction of an officer authorized by the board of directors to prescribe the duties of other officers.[78]

As noted above, the court proceeded to find that the facts showed that both the bylaws of Blairex and a resolution of its board of directors in December 1986 authorized the president to bind Blairex to the royalty agreement. The trial court's finding that the royalty agreement was valid and enforceable was upheld.[79]

These three cases touched on diverse, unconnected issues, but nevertheless are relevant to the daily practice of corporation law. Corporate law practitioners and corporation secretaries might find the Court of Appeals' guidance on counting days for purpose of notice requirements useful, while litigators—familiar with a different counting methodology—likely will find it perplexing. The decision in *Brane* reminds us that ignorance and lack of supervision will not avoid liability: directors have a duty to make informed decisions and to supervise management adequately. Nevertheless, it is important to note that this case was decided under the Indiana General Corporation Act, and the result under the BCL could be different because a breach of the duty of ordinary care is no longer sufficient alone to impose personal liability; the conduct now must also constitute willful misconduct or recklessness. Finally, it

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76. *Id.* at 235-36.
77. *Id.* at 236.
78. IND. CODE § 23-1-36-2 (1988).
79. *Blairex*, 599 N.E.2d at 236-37.

is clear from the third decision that contractual obligations of a corporation authorized in advance by the board of directors and negotiated and signed by the president are binding and that agency law cannot be interposed to void the contract.

III. Limited Liability Companies

Legislation was introduced and enacted in the 1993 session of the Indiana General Assembly that will give Indiana businesses an innovative new option in forming a business organization commonly known as a limited liability company. The Indiana Business Flexibility Act,[80] signed into law on May 13, 1993, adds article 18 to Title 23 of the Indiana Code, thereby bringing Indiana in line with at least seventeen other states that have enacted similar legislation.[81] In addition, at least ten states have proposed legislation permitting the formation of limited liability companies.[82] Prior to the Act, Indiana recognized limited liability corporations formed in other states and required them to register with the Indiana Secretary of State before doing business in Indiana.[83]

A limited liability company is hybrid: it is an unincorporated association with the characteristics of both corporations and partnerships. There are two principal advantages of a limited liability company over other forms of business organizations. First, the "members" of the company, much like corporate shareholders, are not personally liable for the acts or debts of the company, regardless of the extent of their involvement in the management of the corporation. Their maximum liability is limited to the amount of their investment in the company.[84]

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80. Pub. L. No. 8-1993, 108th Gen. Assembly, 1st Reg. Sess. (1993) (adding Ind. Code §§ 23-18-1-1 to -13-1).

81. See Ariz. Rev. Stat. Ann. §§ 29-601 to 29-857 (1992); Del. Code Ann. tit. 6, §§ 18-101 to 18-1107 (1992); Fla. Stat. Ann. §§ 608.401 to 608.471 (West 1982); Pub. Act 87-1062, 1992 Ill. Legis. Serv. 2283 (West) (effective 1-1-1994) (Illinois Secretary of State, *New law: Limited Liability Co. recognized,* Bus. Bull., Dec. 1992, at 4); Iowa Code Ann. § 490A.100 (West 1992); Kan. Stat. Ann. §§ 17-7601 to 17-7651 (1990); La. Rev. Stat. Ann. §§ 9:3431 to 9:3433 (1992); Md. Code Ann. Corps. & Ass'ns, §§ 4A-101 to 4A-1103 (1992); Minn. Stat. Ann. §§ 322B.01 to 322B.88 (West 1992); Nev. Rev. Stat. §§ 86.010 to 86.571 (1991); Okla. Stat. Ann. tit. 18, §§ 2000 to 2060 (West 1992); R.I. Gen. Laws §§ 7-16-1 to 7-16-75 (1992); Tex. Rev. Civ. Stat. Ann. art. 1528n, §§ 1.01 to 9.02 (West 1992); Utah Code Ann. §§ 48-2b-101 to 48-2b-156 (1991); Va. Code Ann. §§ 13.1-1000 to 13.1-1071 (Michie 1991); W. Va. Code §§ 31-1A-1 to 31-1A-69 (1992); and Wyo. Stat. §§ 17-15-101 to 17-15-136 (1977).

82. The states that have pending legislation include Connecticut, Hawaii, Michigan, Missouri, Nebraska, New Hampshire, New Jersey, Pennsylvania, South Carolina, and Tennessee. Martin M. Weinstein & James J. Doheny, Mertens Law of Federal Income Taxation § 35.359.10 n.53.02 (Search of Westlaw electronic database, search of Library MERTENS using "CA(35.359.10)" on April 14, 1993).

83. Ind. Code § 23-16-10.1-1 (Supp. 1992).

84. *See e.g.*, Del. Code Ann. tit. 6, §§ 18-303 & 18-703 (1992).

Second, a limited liability company is treated as a partnership (a "pass-through" entity) for federal income tax purposes, thereby avoiding the double taxation associated with C corporations. In determining the tax status of a limited liability company, one looks to four primary factors: (1) continuity of life, (2) centralization of management, (3) limited liability, and (4) free transferability of interests. If no more than two of the foregoing factors are present, the limited liability company generally will be taxed as a partnership.[85]

As a practical matter, a limited liability company is most closely analogous to a "S" corporation without the attendant restrictions limiting the maximum number of shareholders to 35 and prohibiting subsidiaries and corporate shareholders. A limited liability company also may be viewed as a limited partnership that does not need a general partner with unlimited personal liability and does not restrict limited partner participation in management. Limited liability companies will be of interest not only to those forming a new business, but also to existing limited and general partnerships, S corporations, and certain C corporations.

Under the Act, a limited liability company will be formed by filing articles of organization with the Indiana Secretary of State.[86] The Act also provides that the shareholders will develop a written operating agreement regulating the affairs of the limited liability company, in many respects like corporate bylaws.[87]

IV. Conclusion

Indiana practitioners should look forward to 1993 as a year of exciting developments in laws governing business organizations, including corporations. By contrast, 1992 was a year of consolidation and confirmation: Existing statutory and common-law rules were brushed off and brought forward to address primarily familiar issues and concerns without breaking new ground. Significant developments in Indiana corporation law will have to await another year.

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85. Weinstein & Doheny, *supra* note 82, § 35.359.10 n.53.02 (citing Treas. Reg. § 301.7701-2(a)(1) (1992); *see also id.*, § 35.359.20.

86. Pub. L. No. 8-1993, 108th Gen. Assembly, 1st Reg. Sess. (1993) (adding Ind. Code § 23-18-1-4(a)).

87. *Id.* (adding Ind. Code §§ 23-18-4-4 to -6).