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Agency, Partnership and Corporations

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AGENCY

Auto Leasing Companies—Principals or Agents of Lender?

Two different courts recently expressed opposite views about the legal character of the relationship of the parties to an automobile leasing transaction. In both cases,[1] an automobile leasing company had acted as an intermediary between an automobile dealership and an automobile financing company in arranging to acquire a car to be leased to a customer of the dealership. Had things worked out as planned, the automobiles would have been purchased from the dealership with money provided by the financing company, the cars would have been titled in the name of an affiliate of the financing company—which would have acted as lessor to the dealership's customer—and the customer would have ended up the lessee of the financing company affiliate. But in both cases, the money that was ultimately supposed to be paid to the automobile dealership in exchange for the cars was passed through the hands of a financially troubled leasing company, which used the funds for other purposes and then filed for bankruptcy protection.

As one of the two courts pointed out, the technical question being posed was whether to treat the leasing company as an agent of the financing company, or as a principal party to two related contracts, the first a purchase contract between the dealership and the intermediary, and the second a sales contract between the intermediary and the financing company affiliate.[2] If the intermediary was the financing company's agent, then the dealership had a sales contract with the financing company, and the financing company's transfer of funds to its agent for payment to the dealership would not have satisfied the financing company's obligation to pay the dealership for the cars. If, on the other hand, the financing company had simply purchased the car from the

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1. Duplessis Cadillac v. Creative Credit Services, 564 So. 2d 336 (La. App. 1st Cir. 1990); Willard E. Robertson Porsche-Audi v. General Electric Credit Auto Lease, 544 So. 2d 515 (La. App. 5th Cir.), writ denied, 550 So. 2d 631 (1989).

2. 564 So. 2d at 339.

intermediary, which had earlier purchased it on credit from the dealership, then the dealership had a contract only with the intermediary, and when the intermediary failed to pay, it was the dealership that would have had to bear the loss.

In both cases, the evidence on the nature of the relationship was mixed. The payment terms made the arrangement appear to be a back-to-back contract in which the intermediary leasing company purchased the automobile from the dealership (with funds provided by the financing company), and then resold it to the affiliate of the financing company. But the terms concerning the title documents for the cars made it appear that the cars were being purchased directly by the financing company affiliate from the dealerships, with the leasing company acting as the financing company's agent. The financing company had instructed the dealerships to place the title to the cars directly in the name of the financing company affiliate, and not to pass the title through the leasing company, apparently in an effort to reduce sales tax on the transaction.[3] In effect, therefore, the financing company wished to have the transaction treated as a single sale for sales tax purposes, but as two sales—back-to-back—for purposes of allocating the insolvency risks associated with running the payments for the cars through the hands of the intermediary leasing companies.

Faced with these facts, the Louisiana fifth circuit gave greater weight to the title document instructions:[4] If the financing company explicitly told the leasing company to acquire the cars in the finance affiliate's name, then the leasing company had been given express authority to act as the financing company's agent in the transaction.[5] That meant that the financing company, rather than the dealership, would normally have borne the risk of the intermediary's insolvency (though in this case the dealership ultimately was held liable on other grounds).[6] The first circuit, on the other hand, reversed a trial court summary judgment in

3. 544 So. 2d at 517.

4. The leasing company representative also testified that he was the financing company's agent, although this contradicted his contract with the financing company, which provided that he was not to represent to anyone that he was representing the financing company as its agent. Id.

5. Id. at 518, citing La. Civ. Code arts. 2992, 2996, and 2997. The court might also have noted that the leasing company, under the court's interpretation of the facts, was entering into the transaction in the name of another person, thus meeting the definition of mandate in La. Civ. Code art. 2985.

6. The financing company checked with the dealership to make sure that the dealership had been paid for the cars before it released the funds to the leasing company. The dealership told the financing company that it had received payment, when in fact it had received only a check that it knew would not clear until the financing company had paid the leasing company, and the leasing company had then deposited those funds. 544 So. 2d at 518.

favor of the dealership and indicated that, subject to the facts to be determined at trial, it appeared that the transaction was a purchase and resale, and not a single sale in which the intermediary had acted as the financing company's agent.[7] Under those circumstances, it was the dealership that would have borne the loss that arose from the intermediary's failure to pay.

It might at first seem tempting to suggest that financing companies ought not be able to have it both ways in these types of transactions—to have them treated as a single sale for sales tax purposes, but to have them treated as two-step deals—as a sale and resale—for purposes of allocating the risks of the insolvency of the intermediary leasing company. That argument might indeed be persuasive if the question being posed was whether one or two sales had occurred for sales tax purposes,[8] but the questions posed in these cases are not issues of publicly-imposed tax law. Instead, the courts are being asked simply to determine as a matter of private law the terms of the contracts among the parties. Under contract law, subject to normal fraudulent conveyance and other creditor-protection doctrines, the parties are supposed to be perfectly free to allocate insolvency risks between themselves in any fashion they wish. Indeed, had they dealt with this issue explicitly in their contracts, there would be no real question as to how the issue ought to be resolved.

What the courts are being asked to do in these cases is to determine what the parties should be deemed to have agreed to when their contracts are silent on the subject; the issue of the correct legal classification of the contractual relationship is just an indirect—and potentially distracting—way of asking that basic question. Justice would be better served, therefore, if the courts would let the fair and reasonable expectations of the parties control the classification of the contract, rather than letting some abstract classification scheme impose a set of constructive terms on the parties that they would not likely have expected at the time they entered into their contract. As Judge Shortess suggested in his concurring opinion in the first circuit case, the "classification" question could best be answered in these auto leasing cases by determining who, as between the dealership and the financing company, is best able to ascertain and deal with the risks of the leasing company's insolvency in these types of transactions.[9]

7. Duplessis Cadillac v. Creative Credit Services, 564 So. 2d 336, 339 (La. App. 1st Cir. 1990).

8. Since tax obligations are imposed on persons as a matter of public law, without their individual consent, the fact that they desired and intended to minimize their taxes would not be the controlling factor in determining how many "sales" transactions had occurred.

9. 564 So. 2d at 340.

PARTNERSHIP

Contracting Parties' Intentions Determine Whether Partnership Formed

In two of the partnership decisions reported in the last year, Louisiana courts said that a partnership could not be formed unless the parties to a purported partnership contract wished to form a partnership.[10] If they instead wished to dissolve a partnership,[11] or to become co-owners in indivision,[12] then their wishes would be respected, even if their agreed arrangements had some of the characteristics of a partnership relationship.

These decisions seem sound on policy grounds, but as a technical matter they are not consistent with the bulk of Louisiana jurisprudence on the subject.[13] In theory, the legal classification of a purported partnership contract is not supposed to be something that is subject to the control of the parties to that contract. "Mutual consent" to the contract is indeed one of the accepted elements in all of the prevailing jurisprudential tests of partnership formation,[14] but the "consent" referred to in these various tests is consent to the contract itself, not to the legal classification of the contract. What constitutes a partnership is supposed to be a question of law;[15] it is not supposed to depend upon the consent of the parties. If persons consent to a contract that has the characteristics which the law says are those of a partnership contract, then under the weight of authority in Louisiana, they have become partners with one another because they have consented to a "partnership" contract—whether or not they understood at the time they con-

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10. Guillory v. Hayes, 576 So. 2d 1136 (La. App. 3d Cir. 1991); Roy v. Gravel, 570 So. 2d 1175 (La. App. 3d Cir. 1990), writ denied, 573 So. 2d 1118 (1991).

11. *Roy*, 570 So. 2d at 1179-80.

12. *Guillory*, 576 So. 2d at 1142.

13. See, e.g., Penn v. Burk, 244 La. 267, 152 So. 2d 16 (1963); Latiolais v. BFI of Louisiana, Inc., 567 So. 2d 1159 (La. App. 3d Cir. 1990); Cajun Elec. Power Co-op., Inc. v. McNamara, 452 So. 2d 212 (La. App. 1st Cir.), writ denied, 458 So. 2d 123 (1984).

14. Penn v. Burk, 244 La. 267, 294-95, 152 So. 2d 16, 26 (1963); Darden v. Cox, 240 La. 310, 319, 123 So. 2d 68, 71 (1960); Carr v. Masters, 469 So. 2d 1147, 1149 (La. App. 4th Cir. 1985); John P. Harris, M.D., Inc. v. Parmley, 480 So. 2d 500, 502 (La. App. 5th Cir. 1985); Cajun Elec. Power Co-op., Inc. v. McNamara, 452 So. 2d 212, 215 (La. App. 1st Cir.), writ denied, 458 So. 2d 123 (1984). See Morris, Business Associations, Developments in the Law, 1984-1985, 46 La. L. Rev. 413, 413-20 (1986); Morris, Business Associations, Developments in the Law, 1985-1986, 47 La. L. Rev. 235, 245-46 (1986).

15. Amacker v. Kent, 144 La. 545, 553, 80 So. 717, 720 (1919); *Cajun*, 452 So. 2d at 216 (joint venture, but applying partnership law); Pennington v. Simmons, 138 So. 2d 189, 193 (La. App. 1st Cir. 1962).

sented to the contract how their contract would end up being legally classified.[16]

As these two recent decisions suggest, however, that approach does not make much practical sense where neither third party rights nor issues of public policy are implicated, and where the courts are being asked simply to interpret and enforce, as between the parties themselves, the terms of a contract. In that event, the only functional purpose served by classifying the contract one way or another is to trigger—or to avoid triggering—a series of purely supplètive rules. Thus, when the courts purport to yield to the parties' legal classification in these types of cases, they are really doing nothing but treating the parties' purported classification as an indirect means of rejecting the suppletive rules of partnership law that might otherwise apply.

The only danger posed by this sort of ruling is that the parties' "misclassification" of their contract might not really have been intended by them as a rejection of the suppletive rules in question. Other things being equal, most courts would probably prefer a more explicit rejection. Still, if all the parties to a business arrangement have expressed their intention to have their relationship classified as something other than a partnership, it seems rather unlikely that any one of them could reasonably have understood that the suppletive rules of partnership law were nevertheless going to apply. Absent some reasonable grounds for misunderstanding, therefore, the parties' "misclassification" of their contract with one another should normally be respected—even if "incorrect" from a legal standpoint—to the extent that it operates strictly as an expression of the parties' intentions to reject some or all of these suppletive rules. On the other hand, to the extent that the parties try to use their classification as a means of changing their rights, duties, or obligations under mandatory rules of law, their effort to classify their contract should not be given effect. Private parties do not have the power to override mandatory rules of law either directly or, by misclassifying their contracts, indirectly. The terms of a contract do depend on the intentions of the parties, but the legal classification of a contract, once its terms are established, does not.

Property Ownership

A recent second circuit case, *Johnson & Placke v. Norris*,[17] considered for the first time the question of what is to be required in a "contract of partnership" in order for that contract to satisfy the requirement imposed by Article 2806 of the Louisiana Civil Code that

16. E.g., *Darden*, 240 La. at 320, 123 So. 2d at 72; *Carr*, 469 So. 2d at 1149; *Cajun*, 452 So. 2d at 216.
17. 571 So. 2d 702 (La. App. 2d Cir. 1990), writ denied, 573 So. 2d 1142 (1991).

such "contracts" be written and registered before the partnership's ownership of immovable property is to be fully recognized.

Under Article 2806, the partnership cannot own immovable property, even as among the partners themselves, unless the "contract of partnership" is in writing. As to third parties, the partnership's ownership is not recognized until the "contract of partnership" is filed for registry as required by law. A failure to satisfy these formal requirements makes the partnership's purported ownership ineffective, and replaces it—to the extent it is ineffective[18]—with co-ownership in indivision by the partners.

In *Johnson*, a law partnership purported to own the land and building that served as the firm's law office, and had filed so-called "short-form" articles of partnership with the secretary of state. A lawyer who had withdrawn from the three-person firm was sued by his former partners for an accounting and damages. In reconvention, he sought to partition the law office property on the theory that the filed short-form articles did not constitute a "contract of partnership" as contemplated by Article 2806, so that the law firm office was not actually owned by the law partnership, but by the three lawyers individually, as co-owners in indivision.

There was no question that the property involved had been acquired, improved, and financed in the name of the partnership after the articles had been filed with the secretary of state. But the filed "short-form" articles contained only the name and address of the partnership and of each of the partners, as required by Louisiana Revised Statutes 9:3403 (1991). Nothing was said in the articles about the division of profits, losses or managerial powers among the purported partners. Moreover, even though the short-form articles purported to incorporate by reference a more complete partnership agreement on file at the office of the law firm, the withdrawing partner alleged that no such agreement was on file—or even had been executed—at the time that the short-form articles were filed.[19]

The court held that the short-form articles were adequate because they complied with the minimum requirements of Louisiana Revised

18. If the contract is in writing, but is unregistered, the partnership's ownership is recognized as among the partners, but not against third parties. La. Civ. Code art. 2806.

19. He also alleged that his signature on an undated long-form contract produced in the litigation was either forged or obtained by misrepresentation or other illegality (though he later admitted that his signature on the contract was not forged), and that the short-form articles, because they purported to incorporate a document that did not exist, constituted a mere simulation. The court held that the articles were not a simulation because they accurately expressed the parties' intentions to sign a long-form contract, even if such a contract had not yet been signed, and left it for the trial court to determine whether the alleged misrepresentation or illegality had occurred.

Statutes 9:3403 (1991), an ancillary to Louisiana Civil Code article 2806. Reading the Code and ancillary together, the court concluded that a document satisfying the requirements of section 9:3403 constituted a "contract of partnership" for purposes of Article 2806's "third party" filing rule.[20] The court did not find it necessary to resolve the factual issue regarding the alleged absence of the longer contract that the short-form articles purported to incorporate by reference; the short-form articles were considered adequate in and of themselves.

The court acknowledged that, by their very terms, the rules on the *filing* of partnership contracts dealt only with the requirements imposed to make the partnership's ownership of the property enforceable as against third parties, and that the case before it involved strictly a dispute among the partners themselves. Still, the court said, the short-form articles were satisfactory in this case because third parties had already relied on the partnership's ownership, and because the events that triggered the fight among the partners in this case arose out of the defendant partner's early repayment of the mortgage on the property.

Although the court was careful to limit its ruling to the facts before it, I believe that this potential third-party/inter-partner distinction ought be rejected in all cases, without regard to any evidence concerning third party reliance or dealings. A document satisfying the content requirements of section 9:3403 should be considered a "contract of partnership" for all purposes under Article 2806. The single, uniform rule of section 9:3403 would provide for simplicity and certainty in the interpretation of Article 2806, and it would be consistent with any discernable purpose for imposing the requirement of the partnership writing as between the partners.

As the court pointed out in its discussion of the third party rule of section 9:3403, the Louisiana Civil Code already provides suppletive rules concerning the division of profits, losses and managerial rights among partners. The contract of partnership needs to provide for these items in express terms only if the partners have chosen to depart from the normal equality of rights provided by the Code. It would seem unnecessary, therefore, to say that these items are essential elements that must be included as part of the *writing* that is required to *evidence* the existence of the partnership in order to allow the partnership, as against the partners, to own the immovable property that it had purported to acquire in its own name.

It is difficult to imagine how a literate person who had signed a document which listed the name and address of a "partnership" and its "partners," and listed the signing person as one of the "partners" would not understand that the document purported to describe a part-

20. 571 So. 2d at 705-06.

nership in which he was a partner. If the partnership evidenced by the writing did not in fact exist, then a court would be faced with a factual issue and a parol evidence problem—using testimony or other evidence outside the writing to contradict it—but where, as here, there appeared to be no dispute that the partnership did in fact exist, this form of minimal writing ought to be considered sufficient for the "statute of frauds" type function seemingly performed by Article 2806.[21]

Arbitration Clause Survives Termination of Partnership

In *Levenson v. Steiner*,[22] the fourth circuit held that a provision for arbitration of all disputes "arising out of" a written partnership contract was enforceable in connection with a liquidation-related dispute arising after the termination of the partnership. The original partnership agreement in *Levenson* had been entered into among three partners. It provided for continuation of partnership after death or retirement of a partner, coupled with an obligation on the part of the partnership to pay the former partner for the value of his interest. Disputes about value, or any other controversy or claim arising out of the partnership agreement, were required by the agreement to be resolved by arbitration.

At the time of the transactions in dispute, the partnership's membership had already been reduced from three to two as a result of an earlier withdrawal from the partnership of the third partner. Thus, when one of the two remaining partners withdrew, the number of partners

21. The exact purpose of Article 2806 is difficult to determine; it seems to represent a continuation of pre-1980 law, which had combined several independent rules to arrive at the formally logical (but practically questionable) conclusion that only partnerships created by a writing could own immovable property. Under pre-1980 law, commercial partnerships (whether or not formed through a written contract) could not own immovable property, and all other partnerships had to be formed through a writing, either as a general matter (in the case of universal and in commendam partnerships) or as a result of their owning real estate (in the case of ordinary partnerships). Current Article 2806 continues the basic thrust of the old rules by providing that partnerships may not own immovable property unless the partnership contract is in writing. Oddly, however, even though Article 2806 seems designed to encourage the use and reliance on writings in connection with partnership-related transactions in immovable property, the provision could very well have the opposite effect. The act of sale by which a partnership purported to acquire ownership of immovable property would obviously name the partnership as part of the written act of sale itself. However, if the partnership so named was not evidenced by a separate, written partnership agreement, then the effect of Article 2806 would be to make the partners co-owners in indivision. Unless the name of the partnership happened to contain the names of all the partners, the unexpected new co-owners would not be named in the act of sale (except, perhaps, out of an abundance of caution as a means of dealing with a possible failure of the partnership's title). Thus, the writing requirement of Article 2806 would end up being enforced by placing title in persons whose identities might well have to be proven through parol evidence, in contradiction of the written act of sale.

22. 580 So. 2d 466 (La. App. 4th Cir.), writ denied, 584 So. 2d 685 (1991).

was reduced to one. By operation of law, this terminated the partnership.[23] In the view of the withdrawing partner, it also terminated his obligation to submit partnership-related disputes to arbitration. Without a partnership, he argued, the partnership contract (including its arbitration clause) could no longer be in effect. The district court agreed, and granted the withdrawing partner's request for an injunction against the arbitration proceeding that the other partner had initiated.

On appeal, the withdrawing partner tried to distinguish an earlier decision that had upheld the enforceability of an arbitration clause in an employment contract in connection with a dispute concerning termination of that contract.[24] The withdrawing partner argued that this case was not controlling because it pre-dated the 1980 revision of Louisiana partnership law. The fourth circuit said that there was nothing in the 1980 revision that raised any doubt about the earlier decision, and held that the arbitration clause was enforceable in accordance with its terms, even though the dispute being arbitrated arose in connection with the termination of the partnership. It reversed the district court and dissolved the injunction.

The fourth circuit decision was sound. There was certainly nothing in the 1980 revision of Louisiana partnership law that would have cast any doubts on the earlier arbitration case. But more importantly, had the court accepted the withdrawing partner's argument, doubts would have been created about the enforceability of all termination-related provisions in a partnership agreement. If terms in a partnership agreement could not survive the termination of the partnership, then all termination-related provisions would become ineffective at the very point that they were needed.

Even from a purely technical standpoint, the withdrawing partner's argument was weak. The fact that the partnership had "terminated" did not mean that the partnership's existence as a juridical person had disappeared for all purposes. Even after termination, a partnership continues to exist for purposes of its liquidation until that process is complete.[25] And even if the partnership had terminated as a legal entity, it hardly follows that an agreement clearly connected to the rights of parties upon the conclusion of their relationship would terminate as a result of the termination of that relationship.[26]

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23. La. Civ. Code art. 2826; *Levenson*, 580 So. 2d at 468.

24. 580 So. 2d at 468, citing Wright v. Round the Corner Restaurants of La., Inc., 252 So. 2d 341, 345-46 (La. App. 4th Cir. 1971).

25. La. Civ. Code arts. 2834, 2835.

26. That was the reasoning employed in the earlier employment arbitration case. *Wright*, 252 So. 2d at 345-46.

CORPORATIONS

Legislation

High Risks Created for Retirement Fund Transactions

In what appears to be another piece of anti-takeover legislation, new sections 12:130, 130.1 and 130.2 were enacted to block the use of pension plan assets in connection with the financing of corporate takeovers.[27] Under these new provisions, a two-year, post-merger/change-in-control "safeguard period" is created.[28] During this period, transactions affecting "safeguarded entities" are subjected to strict judicial review[29] and injunctive relief,[30] and persons who during this period engage in "intentional misconduct" which causes either the insolvency of the safeguarded entity or any damage to any "interested person" are required to restore the entity's solvency and to "repair" any damage to an "interested person" (i.e., any beneficiary of the plan), including attorneys' fees and prejudgment interest.[31] "Safeguarded entities" are defined as pension plans, retirement systems, or "any other fund that inures to the benefit of the employees of a corporation" that is "covered" by the Louisiana Business Corporation Law.[32] "Intentional misconduct" is

27. 1991 La. Acts No. 914, § 1.

28. La. R.S. 12:130(1), as enacted by 1991 La. Acts No. 914, § 1.

29. La. R.S. 12:130.1, as enacted by 1991 La. Acts No. 914, § 1.

30. La. R.S. 12:130.2(B), as enacted by 1991 La. Acts No. 914, § 1.

31. La. R.S. 12:130.2(C), as enacted by 1991 La. Acts No. 914, § 1.

32. La. R.S. 12:130(2), as enacted by 1991 La. Acts No. 914, § 1. The meaning of "coverage" by the Louisiana statute is unclear. Perhaps the reference to the Louisiana statute was intended to limit the reach of the new provisions to Louisiana-chartered corporations, but new "coverage" language was unnecessary if that was the intended meaning. The term "corporation" as used in the Louisiana statute was already defined as a corporation formed under the provisions of the Louisiana statute, La. R.S. 12:1(G) (1969). Perhaps the term was used deliberately for the very opposite purpose—to reach corporations other than those actually incorporated in Louisiana. An anti-takeover provision that was adopted in 1988, for example, purports to apply to non-Louisiana corporations that have certain connections with Louisiana. La. R.S. 12:140.11-140.17 (Supp. 1991); Morris, Business Associations, Recent Developments in the Law, 1987-1988, 49 La. L. Rev. 277, 280-86 (1988). Also, the general merger provisions of the corporate statutes "cover" foreign corporations in the sense that they describe how a merger or consolidation with a foreign corporation is to be conducted. La. R.S. 12:111-116 (1969 and Supp. 1991). Thus, even foreign corporations combining with or having certain connections to Louisiana might be covered by the new safeguarded entity provisions.

defined as any intentional conduct[33] which *has the effect of* diminishing the assets "being held in trust" by any safeguarded entity.[34]

In view of the fact that few financial transactions occur through an unintentional slip of the hand, the "intentional" requirement of the statute may do little to limit its reach. It seems likely that most transactions affecting retirement funds are "intentional" in the sense that the participants intend for the transaction to occur. Unless the "intentional" requirement is interpreted to apply to the *effects* of the transaction, the new statute will for all practical purposes impose virtually absolute liability for losses suffered by retirement funds as a result of transactions that occur during the two-year "safeguarded" period.[35]

Unlike most anti-takeover provisions,[36] this one applies to all corporations that are "covered" by the Louisiana business corporation statute, no matter how small or closely-held that corporation might be. Thus, even in a small family business, whenever a merger, consolidation, or *change in majority voting ownership* has occurred (which might occur, for example, as the result of the sale of the business or the death of a majority shareholder), a two-year high risk period is created following the change-in-control during which any transaction that might have the effect of "diminishing the assets" of an employee benefit plan will trigger unpredictable, potentially enormous exposure for all persons[37] whose conduct may be deemed to have caused the diminution in assets.

Cases

No Veil Piercing Despite Informalities

In *Henry J. Mills Co. v. Crawfish Capitol Seafood, Inc.*,[38] the third circuit affirmed a trial court's refusal to pierce the corporate veil for

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33. Conduct that violates the new provisions is presumed to be intentional misconduct. La. R.S. 12:130.1(A), as enacted by 1991 La. Acts No. 914, § 1. But conduct does not violate the new provisions unless it is intentional, La. R.S. 12:130(4), as enacted by 1991 La. Acts No. 914, § 1, so the intended effect of the presumption is unclear.

34. La. R.S. 12:130(4), as enacted by 1991 La. Acts No. 914, § 1. Act 914 also amended an existing portion of Louisiana's control share acquisition statute, to make the filing of an "acquiring person statement"—which is normally optional—mandatory in cases in which any of the shares being acquired are held in an account or fund on behalf of a safeguarded entity. La. R.S. 12:137(B), as amended by 1991 La. Acts No. 914, § 1.

35. The "being held in trust" language, on the other hand, may be rhetorical overkill that could have the effect of preventing these otherwise expansive liability provisions from reaching retirement funds not formally structured as trusts.

36. See La. R.S. 12:131-140.17 (1969 and Supp. 1991).

37. The liability imposed by the new provisions is not limited to plan administrators. La. R.S. 12:130.2(A), as enacted by 1991 La. Acts No. 914, § 1.

38. 569 So. 2d 1108 (La. App. 3d Cir. 1990).

the benefit of a contractual creditor of the corporation. The case is noteworthy because the corporation involved seemed to be organized and operated in a fairly typical, though theoretically unacceptable way: informally and without much regard for the statutory model of corporate governance. The corporation in *Mills* was formed by three individuals, who acted as the incorporators, officers and directors of the corporation, and who apparently agreed to divide ownership of the corporation equally in exchange for future services; no stock certificates were ever issued. The corporation obtained approval for loan financing from the Louisiana Department of Agriculture, and then interim financing from Breaux Bridge Bank in the amount of $160,000. For some reason not described in the record of the case, the permanent financing from the state fell through, and the bank, having been taken over by the F.D.I.C., called its loan. The corporation ceased operations, apparently having expended some of the loaned funds on the renovation of a restaurant for use in processing the seafood, and having processed seafood on a few occasions. The corporation was never formally liquidated. A creditor of the corporation sued to collect roughly $15,000 due on open account, and to have a materialman's privilege recognized.

The black letter doctrine recited by the court was unremarkable, but its application in this case should be helpful to practitioners attempting to defend against a veil-piercing attack. The court refused to pierce the veil in this case despite the fact that the corporation was capitalized entirely with borrowed funds. The purported shareholders were said to have contributed services to the corporation in exchange for their shares, but the nature and value of these services were never described in any formal way. No bylaws were enacted, and no minutes existed of any shareholder or director meeting. Financial records were "unavailable," and there was evidence that one of the shareholders had utilized corporate assets in operating another business owned by the shareholder.

The court considered the debt financing to be acceptable, pointed out that neither bylaws nor minutes of meetings were required by law, and said that the failure to issue stock certificates was "insignificant." The court explained that the lack of financial records was understandable in view of the corporation's limited, aborted operations, and ruled that occasional personal use of some of the corporate assets was not a sufficient commingling of corporate and personal assets to justify veil-piercing. The court even treated undocumented discussions among the three purported shareholders as "shareholder meetings" that counted against the veil-piercing argument.[39]

39. Id. at 1111.

This is not the first Louisiana case that has been liberal in recognizing a corporation's separate existence against the claim of a contract creditor, even in the face of evidence that the shareholders operated the business more as a proprietorship than as a corporation.[40] These cases make sense not so much on their stated rationales (the black letter law is so vague that almost any result can be defended as a technical matter), but on simple contract grounds. A person who sells goods or services to a corporation on credit, without obtaining any personal guarantees from the corporate shareholders, is implicitly agreeing to a form of nonrecourse financing; he is agreeing to look only to the corporate assets for the payment of the debt owed to him. Veil-piercing in this type of case would let the creditor circumvent the terms of his contract, and courts are understandably reluctant to let this happen. Unless there are facts to suggest either that the creditor did not and could not reasonably be expected to understand the nature of his contract, or that the shareholders were making factual misrepresentations, or were commingling or transferring assets out of the company in a way that suggested a lack of good faith on their part, the reported Louisiana decisions consistently refuse veil-piercing demands by the corporation's contractual creditors—even where corporate formalities have virtually been ignored.[41]

Piercing to Non-Shareholders

Cannot Pierce to Non-Shareholder

Two decisions reported last year reached opposite conclusions about the potential liability of non-shareholders for corporate debts under a veil-piercing theory. One explicitly held that non-shareholders may not be held liable under a veil-piercing theory, while the other seemed not to be troubled by imposing such liability on a person who, as a formal matter, held no such position. The latter decision seems better reasoned.

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40. Other cases include West Bldg. Materials, Inc. v. Daley, 476 So. 2d 554 (La. App. 3d Cir. 1985); Harris v. Best of Am. Inc., 466 So. 2d 1309 (La. App. 1st Cir.), writ denied, 470 So. 2d 121 (1985); Cahn Elec. Appliance Co. v. Harper, 430 So. 2d 143 (La. App. 2d Cir. 1983); Ceco Corp. v. R & M Indus., Inc., 416 So. 2d 166 (La. App. 4th Cir.), amended, 425 So. 2d 709 (La. 1982); Kingsman Enter., Inc. v. Bakerfield Elec. Co., 339 So. 2d 1280 (La. App. 1st Cir. 1976).

41. In this regard, the Louisiana jurisprudence is consistent with Section 25 of the Model Statutory Close Corporation Supplement to the Revised Model Business Corporation Act (1985). This provision states that, in the case of a statutory close corporation (one with 50 or fewer shareholders that opts into the close corporation statutory scheme), the failure to observe normal corporate formalities is *not* a ground for imposing personal liability on the corporate shareholders.

In the first case, *Riggins v. Dixie Shoring Co.*,[42] a homeowner obtained a judgment against the 98% shareholder of a foundation repair corporation and the 98% shareholder's son. The judgment was based on faulty workmanship on a job that the corporation had contracted to perform. The suit against the corporation itself—which the court said had no remaining assets—was stayed as a result of its filing for bankruptcy protection during the course of the litigation. In support of its decision to pierce the veil, the trial court had pointed out that the father and son had engaged in a number of irregularities that made it impossible to determine accurately what assets had actually belonged to the corporation, and what assets belonged to the shareholders or to other affiliated businesses. Among other things, the father and son kept little documentation of corporate transactions. They asked customers to pay them with checks made payable to them personally, and then without telling the company's accountant about them, cashed the checks and kept the funds in a safe. Moreover, in the year before causing the corporation to file for bankruptcy, over $100,000 in corporate assets disappeared, and following the corporation's bankruptcy, a new corporation began operating the very same business, with the same phone number, and using much of the same equipment that had been used in the earlier corporation's business.

Accepting these factual findings, the fourth circuit affirmed the trial court's piercing of the corporate veil against the 98% shareholder. But it reversed the judgment against the shareholder's son. According to the court,

> The purpose behind the doctrines of "piercing the corporate veil" and "alter ego" is to protect a creditor in his dealings with a shareholder who fails to distinguish, in transactions, between the corporation and his identity as a shareholder. [Citation omitted.] Thus, these doctrines are applicable only against the shareholders of a corporation. The doctrines are not applicable to employees and/or officers who are not also shareholders in the corporation.[43]

In contrast, the third circuit saw no difficulty in piercing a corporate veil to a person who was not, formally speaking, a shareholder in the "pierced" corporation. In that case, *Withers v. Timber Products, Inc.*,[44] the corporation was held liable for a workers' compensation claim for

42. 577 So. 2d 1060 (La. App. 4th Cir.), writ granted, 581 So. 2d 697 (1991), rev'd on other grounds, No. 91-C-0963, 1991 WL 255914, 1991 LEXIS 3373 (Dec. 2, 1991).

43. 577 So. 2d at 1065. The supreme court later reversed the veil piercing itself, finding inadequate support in the record for certain key factual findings, but it expressed no views on the possibility of imposing veil-piercing liability on a non-shareholder.

44. 574 So. 2d 1291 (La. App. 3rd Cir.), writ denied, 580 So. 2d 378 (1991).

which it carried no insurance. The person who appeared to be in control of the corporation had testified that the decision not to carry insurance was a calculated risk that no one would get hurt, and that if someone did get hurt, they would get paid only if the business was "doing good."[45] Although this individual had formed the corporation, and had formerly owned another corporation that had earlier operated the same business from the same site with the same manager, he had purported to swap 100% of the new corporation's stock for some non-revenue producing land owned by another person, a two-time felon who testified that he was "judgment proof," had never visited the business that he was supposed to own, and knew nothing about its operations or finances. This purported 100% owner even lacked the power to sign checks on the business account, while the "non-shareholder" did have this power.

Although the *Withers* court did note that there was no record evidence that the purported stock swap had ever really occurred,[46] the court's decision did not turn on a resolution of this factual dispute. Without any discussion of whether the person in control of the corporation was, as a formal matter, a shareholder in the corporation, the court affirmed the trial court's piercing the veil to him.

In the only other reported case to consider this issue,[47] *Brown v. Benton Creosoting Co.*,[48] the second circuit took the same position as the *Withers* court. It pierced the veil of a corporation to hold a creditor of the corporation—a major corporate supplier—personally liable for a workers' compensation claim owed by the corporation to one of its employees. The creditor had for several years held a mortgage on the assets of the corporation and a pledge of the corporate stock, and had through its agents controlled the operation of the corporation. The corporation's net receipts were credited against the indebtedness owed

45. 574 So. 2d at 1295.

46. 574 So. 2d at 1295. Presumably, the court meant no documentary evidence, as there was testimony to the effect that such a transfer had occurred. Id.

47. In Green v. Champion Ins. Co., 577 So. 2d 249 (La. App. 1st Cir.), writ denied, 580 So. 2d 668 (1991), the court did pierce the veil of several affiliated corporations, finding them to have been operated as a "single business enterprise." Technically, this amounted to veil-piercing to non-shareholders, i.e., to sister corporations under common ownership by a third person or corporation. However, this type of case is distinguishable from those discussed in the text, for it involves the treatment of several affiliated corporations as if they were a single corporation, not the imposition of personal liability on a non-shareholder on grounds that his relationship to the corporation was, in substance, similar enough to ownership to justify holding him liable under a veil-piercing theory. Another case, McGregor v. United Film Corp., 351 So. 2d 1224 (La. App. 1st Cir. 1977), writ denied, 353 So. 2d 1335, 1341 (1978), held two corporations under common control liable as "employers" of an injured worker, but the result was explained through a "joint venture" rather than "veil-piercing" theory.

48. 147 So. 2d 89 (La. App. 2d Cir. 1962).

by the corporation to its controlling creditor, but this indebtedness constantly increased rather than decreased in amount. None of the nominal owners of the business were ever consulted about the operations of the business, and a purported 50% shareholder had not visited the business in several years, and did not believe that he had any interest in it.

Neither the *Brown* nor *Withers* court even noted that their results were out of the mainstream of veil-piercing cases, so neither saw any need to refute the view presented in *Riggins* that veil-piercing was limited in its application to shareholders. But with the *Riggins* statement now made part of the Louisiana jurisprudence, taking a position contrary to the results in *Brown* and *Withers*, future courts might be required to choose between these two competing views. If so, I would hope that the *Riggins* statement[49] would be rejected and that the *Brown/Withers* position would prevail.

Although it is true that the persons held liable under a veil-piercing theory are almost always controlling shareholders of the pierced corporation, it seems wrong to suggest, as the *Riggins* court did, that the formal positions of the defendants as shareholders or non-shareholders ought always to be considered controlling in identifying the persons who should be held personally liable for the debts of the "pierced" corporation. The very point of veil-piercing is to avoid injustice by disregarding the formal structure of a transaction or relationship in favor of its substance—to impose personal liability on persons who have, in substance, run their nominally incorporated business in a way that makes it unfair to allow them to deny their responsibility for the obligations of the business by interposing the corporation's separate legal personality. But if the corporation's very existence is to be disregarded in a veil-piercing case, it hardly makes sense to resurrect the stock ownership records of the legally nonexistent corporation as a means of limiting the class of persons that may be found to have acted in a way that justifies making them personally liable under a veil-piercing theory.

Withers itself provides a perfect, though extreme, example of why the fourth circuit limitation on veil-piercing defendants should be rejected. A person might act, in substance, as the sole owner of a business without holding that position as a formal matter. Indeed, formal share ownership might be relinquished, as it seemed to be in *Withers*, for the very purpose of transferring veil-piercing liability to another, judgment-proof person. If veil-piercing doctrine is to mean anything at all, it is important that the de-facto owners of a business not be allowed to achieve through a sham stock transfer what they would not be allowed

49. The fourth circuit decision in *Riggins* was reversed by the supreme court, but on other grounds.

to achieve through the establishment of the alter ego corporation itself. This does not mean that all participants in an incorporated business ought to be subjected to veil-piercing liability. It simply means that the class of persons who may be proven by the plaintiff to have operated an incorporated business as their "alter ego"—in the sense that term is generally used in veil-piercing cases—ought not be limited artificially to those persons who, as a formal matter, hold shares of stock in the corporation being pierced.

Personal Liability of Corporate Officer for Misappropriation

In *Sencore, Inc. v. Boes Iron Works*,[50] the fourth circuit held a corporate employee[51] personally liable for the misappropriation of property being auctioned by the plaintiff auctioneer. The court rejected the defendant's argument that he could not be held liable for the misappropriation because he had been acting strictly in a corporate capacity. The court cited Louisiana Revised Statutes 12:95 (1969), which states that the corporate statute does not derogate the rights of any person to sue a corporate shareholder, director, or officer for fraud. The court also quoted the statement in *Fryar v. Westside Habilitation Center*,[52] that "[a]n employee cannot shield himself behind a corporate wall when he is the officer responsible for the corporation's acts in a particular transaction."[53] The court concluded that because this was a tort rather than contract case, the defendant could indeed be held personally liable.

Although I have already expressed my strong disagreement with the *Fryar* language quoted by the court in this case,[54] I believe that liability was properly imposed in this case because, as the fourth circuit stated, the duty that was breached in this case was one that has traditionally been imposed by tort law. The duty not to steal another person's property is not a duty that unduly interferes with the freedom of the parties to allocate contractually the risks associated with their transactions with one another.[55]

50. 562 So. 2d 1154 (La. App. 4th Cir. 1990).

51. It seems likely that the employee was the controlling shareholder of the corporation, as the corporation bore his name, but the decision does not describe the defendant's relationship to the corporation as anything other than "employee."

52. 479 So. 2d 883 (La. 1985).

53. 562 So. 2d at 1156, quoting *Fryar*, 479 So. 2d at 890.

54. Morris, Business Associations, Recent Developments in the Law, 1985-1986, 47 La. L. Rev. 235, 242-245 (1986); Morris, Business Associations, Recent Developments in the Law, 1988-1989, 50 La. L. Rev. 211, 217-20 (1989).

55. For a discussion of the distinction between the contract and tort liability of agents, see Morris, Developments in the Law, supra note 54, 50 La. L. Rev. at 220-26.

Cash-Out Merger Used Successfully to Defeat Minority Shareholder's Fiduciary Duty Suit

The case of *Armand v. McCall*,[56] began as a typical fiduciary duty suit by the heirs of one of the original investors in a closely held corporation, but ended up, along with the companion case of *McCall v. McCall Enterprises*,,[57] as a judicial affirmation of the lopsided allocation of powers granted by the merger provisions of the Louisiana corporation statute. The plaintiffs in *Armand* had inherited 7.5% of the shares of the corporation from their parents, and had apparently expressed some dissatisfaction about the management of the corporation. In compliance with the procedural requirements imposed in connection with shareholder derivative lawsuits,[58] the plaintiffs first sent a letter to the corporation in the nature of a demand that the corporation enforce its rights against the controlling shareholder, and then filed a derivative action alleging that the defendant had breached his fiduciary duties to the corporation.

The controlling shareholder responded by causing the parent company of the corporation involved[59] to engage in a cash-out merger in which the plaintiff shareholders were required to relinquish their corporate shares in exchange for a cash payment fixed, practically speaking, by the controlling shareholders of the corporation.[60] The plaintiffs exercised their statutory right to dissent from the merger. Although this would normally have entitled them to overcome the corporation's offered price with a judicial determination of a "fair" price, the shareholders

56. 570 So. 2d 158 (La. App. 3d Cir. 1990), writ denied, 575 So. 2d 375 (1991).

57. 578 So. 2d 260 (La. App. 3d Cir.), writ denied, 581 So. 2d 708 (1991).

58. La. Code Civ. P. art. 596.

59. Over a period of the two to three years preceding the sending of the demand letter, more than 90% of the stock of the corporation had been acquired by another corporation, one apparently controlled by the defendant shareholder. (The opinion is silent on this point, except for noting that the defendant was a shareholder and officer of the other corporation, and except for the fact that the other corporation bore his name.) Although this case involved a merger with a 90% parent, substantially the same technique could be used in most corporations in which the majority shareholders owned (or could cause to be issued to themselves or their allies) two-thirds or more of the voting shares of the corporation; only the formal procedures would change.

60. In theory, it was the corporate entity that set the price, but the corporation obviously voted to do what those in control of the corporation wished for it to do. Normally, in a merger, the plan must be approved by the board of directors (elected by the majority shareholders) and by two-thirds of shareholder voting power present at a duly convened shareholders' meeting. La. R.S. 12:112(A), (C)(2) (Supp. 1991). In this case, because the parent corporation owned 90% or more of the shares of the other company, and the merger did not result in the parent company's issuing or delivering any of its shares, the merger did not require a vote of the shareholders of either corporation. It could be carried out through a simple resolution of the board of directors of the parent corporation. La. R.S. 12:112(E), (G) (Supp. 1991).

in this case faced a procedural problem: under Louisiana Revised Statutes 12:131(C) (Supp. 1991), both a demand for payment and an escrow acknowledgement letter[61] were required to be delivered to the corporation within twenty days of the date that the corporation mailed notice of the cash-out merger to the shareholders.[62] In this case, the shareholders' demand for payment was delivered in time, but the acknowledgement letter was two days late.

Following the merger, the defendant shareholder attacked both the derivative suit and the dissenter's action. In the derivative suit, he filed an exception of no right of action on grounds that the plaintiffs were no longer shareholders, and so no longer were entitled to bring a derivative suit on behalf of the corporation. In the dissenter's action, he argued that the shareholders were not entitled to the enforcement of their rights because they had failed to comply with the twenty-day escrow acknowledgement requirement. The defendant won on both counts. The trial court granted the exception of no right of action in the derivative action because—as a result of dissenting—the plaintiffs were no longer considered to be shareholders, and it dismissed the dissenter's action on grounds that the plaintiff's had failed to comply with the twenty day period for the delivery of the escrow acknowledgement letter. The third circuit affirmed both decisions, and in the derivative suit even adopted the trial court's reasons as its own.[63]

In both suits, the court's reasoning was straightforward. The court pointed out that derivative suits can be brought only by shareholders, and according to the dissenter's rights statute, a dissenting shareholder loses his rights as a shareholder (except his right to be paid under the dissenter's provisions) as soon as he makes demand for payment under the dissenter's rights provision.[64] The shareholders had made demand for payment in this case, and were therefore no longer shareholders. They no longer had any right of action to pursue the derivative lawsuit.[65]

In the dissenter's suit, the court found that the statute imposing the twenty-day period had not been satisfied, and rejected the plaintiff's argument that substantial compliance should be enough. Since the statute said twenty days for both the demand and acknowledgement letter,

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61. The stock certificates representing the shares as to which dissenters' rights are being asserted must be endorsed by the dissenting shareholder in favor of the corporation, and deposited in escrow in a bank or trust company for delivery to the corporation upon the condition that the corporation pay the amount determined to be due in accordance with the dissenters' rights provisions. La. R.S. 12:131(C) (Supp. 1991).

62. Id.

63. Armand v. McCall, 570 So. 2d 158, 161 (La. App. 3d Cir. 1990), writ denied, 575 So. 2d 375 (1991).

64. 570 So. 2d at 160, citing La. R.S. 12:131(H) (1969).

65. Id.

twenty days on the demand and twenty-two on the acknowledgement was not good enough, even if the corporation had not suffered any discernable prejudice from the two-day delay.[66]

These two cases may be placed in better perspective by considering the role that fiduciary duty suits play in the resolution of disputes between minority and majority shareholders in a closely-held corporation. Minority shareholders in such a corporation will often believe that a substantial minority stake in a valuable business ought to have some inherent economic value, value that is somehow independent of the virtually unfettered discretion of the controlling shareholder over the corporation's distribution of dividends, salaries and other economic benefits. This view is particularly likely among shareholders who were not privy to the informal understandings reached among the corporation's original investors, but who acquired their stock in some later transaction—such as a divorce or inheritance—in which the stock was treated simply as another item of property that could be fully owned and exploited by the person who was identified as its "owner." Shareholders who view stock in a closely-held corporation in this way will often be disappointed when the majority shareholders never declare any dividends (they don't need to—salaries can be used to take care of the majority shareholders and selected kin) and when they find themselves unable to sell the stock for anything approaching their theoretically proportionate share[67] of the value of the business as a whole (the market price for the minority stock is quite low since the present discounted value of zero dollars in anticipated future dividends is zero).

When the new minority shareholders make demands for what they believe is their fair share of the corporate earnings—based on their nominal percentage of stock ownership—the still-active, full-time controlling shareholders will tend to see the minority owners as meddlesome parasites, seeking something for nothing and sticking their noses where they don't belong. Their demands may also seem to the majority shareholders to be in violation of the longstanding, though informal, understandings reached among the original investors about the company's operations and distributions policies. Thus, a corporation that has been fair, even generous, in distributing benefits to a shareholder who was active and productive in the corporation's business may feel that the shareholder was being fully compensated during his lifetime for his contributions, and so may be rather stingy in declaring dividends in

66. McCall v. McCall Enter., 578 So. 2d 260, 263 (La. App. 3d Cir. 1991).

67. Subject to few exceptions (principally in cases of classified shares and anti-takeover measures), all shares are supposed to have equal rights. La. R.S. 12:51(C) (Supp. 1991). In theory, therefore, the per-share value of a 49% stake in a corporation ought to be the same as a 51% stake.

respect of some theoretical residual value in the business purportedly held by the nonproductive heirs of that shareholder.

These are difficult disputes to resolve. Both sides have solid grounds for their views, and neither view can ever really be reconciled with the other. Yet unless the shareholders have negotiated a buy-sell agreement in advance, or the minority shareholder is willing to accede to the majority's view by relinquishing his shares for a deeply-discounted price, the law says that the two sides must stay together in the same corporation and just fight it out. As a result, a breakdown in relations that might be resolved by a partition or withdrawal in other types of property or business co-ownership will often end up in a corporate setting as a derivative lawsuit alleging various breaches of fiduciary duty on the part of the corporation's controlling shareholders.

The fiduciary duty lawsuit is not an end in itself, of course, for even if the plaintiff shareholder is successful on the merits of the claim, a derivative suit will generally not result in a judgment in favor of the plaintiff shareholder, personally, but only in a judgment in favor of the corporation.[68] The corporation is still not required actually to distribute the recovery to the shareholders, as a decision on the declaration of dividends is thought to be a matter for the business judgment of the directors of the corporation—the folks who just lost the fiduciary duty lawsuit. On the other hand, since the plaintiff shareholder is still in a position to force the controlling shareholders to defend all transactions in which they may be seen to have a personal interest—such as salary payments—even "success" for the defendant does not finally settle things. Any particular transaction may have survived judicial scrutiny, but a judgment in that case—for that transaction—is certainly not res judicata with respect to all future transactions in which the corporation may wish to engage. The plaintiff therefore remains a problem as long as he or she remains a shareholder. The only way to settle these suits, permanently, is to buy out the dissident shareholders.

Thus, in the end, the fiduciary duty lawsuit is filed not so much to resolve a dispute about management as to obtain indirectly what is not supposed to be available under traditional corporation law: a mandatory buy-out of a dissatisfied minority investor. Even though the

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68. See La. Code Civ. P. art. 596 (4) (petition in derivative action must include prayer for judgment in favor of the corporation). A few decisions outside of Louisiana have allowed derivative suit judgments to be granted directly in favor of the plaintiff shareholders, in proportion to their ownership of stock, to prevent the defendants from participating in a windfall from the corporate recovery. See Jannes v. Microwave Communications, Inc., 385 F. Supp. 759 (N.D. Ill. 1974); Young v. Columbia Oil Co., 110 W. Va. 364, 158 S.E. 678 (1931). But see In Re Pittsburgh & Lake Erie R.R. Co. Securities and Antitrust Litig., 387 F. Supp. 906 (E.D. Pa. 1974); Keenan v. Eshleman, 23 Del. Ch. 234, 2 A.2d 904 (1938).

plaintiff shareholder has virtually no chance of recovering anything personally as a direct result of winning his fiduciary duty lawsuit, the suit remains valuable to him as a means of imposing buy-out pressure on the controlling shareholders.

What is important about the *Armand* and *McCall* cases, therefore, is that the typical buy-out pressure from the minority investors got turned around on them. The defendants' lawyers seized control of the fiduciary duty suit by means of a squeezeout merger that left the minority stockholders with limited and fragile rights that they ultimately ended up losing through their failure to comply with a statutory twenty-day demand and escrow requirement.[69] No doubt, that was good lawyering by defense counsel. But it was not a fair way for the law to resolve this dispute. *Armand* and *McCall* essentially sanction an expropriation of a minority shareholder's stock even without the provision of a reasonable opportunity for judicial review of the terms of the expropriation.

Although it is possible in this case to criticize the court's reading of the statute on technical grounds,[70] the technical criticisms, even if

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69. The only "out" for the shareholder that the court seemed to see was a contesting of the lawfulness of the merger itself. 570 So. 2d at 160. (The court apparently did not view an attempted assertion of dissenters' rights—in an effort to increase the price to be paid for the shares—to be an objection to the lawfulness of the merger itself.) But there seemed to be no doubt that the corporation had complied with the formal, technical requirements of the merger statute. Id. at 159. And it is not at all clear whether a court would allow a "fiduciary duty/unfairness" attack on the merger or whether, instead, the dissenters' rights provisions would be considered exclusive of other "fairness"-based remedies. No reported Louisiana decision has dealt with the question explicitly, and decisions outside Louisiana are mixed. V. Brudney & M. Chirelstein, Corporate Finance, at 737-42 (3d ed. 1987). Some courts have been willing to enjoin a freeze-out merger if it is being carried out for purposes of eliminating the minority shareholder's standing in a derivative suit. Coleman v. Taub, 638 F.2d 628 (3d Cir. 1981) (not enjoined because other contractual remedies available to shareholder); Merritt v. Colonial Foods, Inc., 505 A.2d 757 (Del. Ch. 1986).

One Louisiana decision, Levy v. Billeaud, 443 So. 2d 539 (La. 1983), does suggest that a merger-like transaction might be struck down as a breach of a duty of "entire fairness" to minority investors, even if it is carried out in accordance with the letter of the corporate statute. This reading of *Levy* would support the position that the statutory dissenter's remedies are not exclusive and that mergers designed to thwart derivative suits are unlawful. But, as a technical matter, *Levy* was written simply as a decision dealing with the fiduciary duties of corporate liquidators.

70. In one decision, the court dismissed the derivative suit on grounds that the shareholders had lost their standing as shareholders by the act of making the "demand" for payment under the dissenters' rights statute, La. R.S. 12:131(C) (Supp. 1991), while in the other it held that the "demand" was ineffective to trigger their rights under the dissenters' rights statute. From a technical standpoint, the word "demand" seems to have a fixed, particular meaning under the statute; either the shareholder made a "demand" as contemplated by the statute or he didn't. The statute does not seem to allow a shareholder communication to be treated as a "demand" for purposes of giving up rights

heeded, would not necessarily change the result.[71] The real fault in this case lay not with the court's interpretation of the statute, but with the statute itself.

Originally, dissenters' rights statutes were designed to protect a minority shareholder from "freeze-in" transactions—from being forced to accept stock in a new, merged company in exchange for his original investment in one of the corporate parties to the merger.[72] Accordingly,

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as a shareholder, without also operating as a "demand" for purposes of protecting the former shareholder's rights as a dissenter. The *McCall* decision quoted the portion of La. R.S. 12:131(H) (1969) that provided for the shareholder's relinquishment of his shares upon the filing of his demand, but it omitted a later portion of the same subsection that provided for the reinstatement of the dissenter as a shareholder in the event, among others, that the shareholder should in any way lose his rights as a dissenter.

71. Even if the court had adopted the analysis suggested supra note 70, it would have faced the question of how to deal with the reinstated dissenter. If the loss of the dissenters' rights resulted in reinstatement as a full-blown shareholder, then the corporation would be forced to choose between enforcing the terms of its cash-out merger and enforcing its rights under the dissenters' rights statute. Under this approach, a dissenter could violate the procedures of the statute with virtual impunity if the corporation wished to enforce the terms of its merger, for if the company did not forgive the dissenter's failure to comply with the statute, it would find him reinstated as a shareholder, thus defeating the purpose of the cash-out merger in the first place.

On the other hand, if reinstatement meant reinstatement to the position that the shareholder would have occupied had he not dissented, then the reinstatement would make no real difference in the dissenter's position. He would end up being reinstated to the very position—recipient of a low-ball cash merger price—from which he was trying to dissent. In effect, the *McCall* court opted for this latter choice, though it did not explain its decision in this way. But since the court *might* have reached the unfair result that it did in a technically defensible way, it is difficult to say that the unfairness in the result reached actually arose from a misinterpretation of the statute.

The statute worked unfairly in this case not because it was interpreted badly, but because it was designed to deal with the exact reverse of the type of transaction that actually occurred in this case—a "freeze-in" rather than "freeze-out" type of merger. See infra text accompanying notes 72 to 75. In a freeze-in merger, the statutory "dissenter or shareholder" choice works reasonably well. If a shareholder does not dissent, he simply remains a shareholder in the surviving corporation. If he does dissent and protects his rights, he gives up his shares in exchange for his dissenter's rights. If he later loses his rights as a dissenter (e.g., by failing to satisfy the statutory notice requirements), he is simply reinstated as a shareholder.

In contrast, in a freeze-out transaction, the choice is not "dissenter or shareholder," but "dissenter or *former* shareholder." If the cash-out merger is not to be defeated altogether, the shareholder who is reinstated is reinstated to his entitlement to get whatever it was that the controlling shareholders decided to offer. In practical effect, the shareholder has his property expropriated from him against his will and loses his right to challenge the price at which the expropriation occurred if he fails to satisfy what must amount to one of the shortest prescriptive periods anywhere in the law: twenty days from the mailing of notice.

72. In early corporate law, mergers required the unanimous consent of the corporation's shareholders. The dissenters' rights provisions were seen as the tradeoff required

the shareholder was given the right to demand a cash payment for his shares at their fair value. If the corporation and shareholder could not agree on "fair value," the value was to be determined by a court in what is generally known as an "appraisal" proceeding. The procedures established in the statutes for the assertion of dissenters' rights tended to be rather lopsided in favor of the corporation—with very short time periods within which a series of steps had to be completed—in order to counter the fears of critics of dissenters' rights. The critics feared that minority shareholders would be able to impose unpredictable and unmanageable cash-flow pressures on the merged enterprise by demanding a cash payment for their shares, rather than simply accepting stock in the merged enterprise like everyone else. In effect, liberal dissenter's provisions could be used by minority shareholders to destroy a transaction that a majority of the shareholders considered beneficial.[73]

The "freezeout" or "cash-out" merger, such as the one carried out in this case, turned the dissenters' rights statutes on their heads.[74] Now the merger terms were objectionable to the minority investors precisely *because* they were not being given the chance to be treated as everyone

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to reduce the approval requirement to a majority or two-thirds of shareholders; a minority shareholder could not block the transaction for everyone, but neither was he required, against his will, to leave his money invested in a company that had undergone the purportedly "fundamental" change wrought by a merger. He lacked the power to block the merger, but if he did not wish to remain in the merged enterprise, he was entitled to assert his dissenter's rights to a cash buy-out of his investment. See R. Clark, Corporate Law, at 443-44 (1986); Manning, The Shareholder's Appraisal Remedy: An Essay for Frank Coker, 72 Yale L.J. 223, 244-50 (1962); Lattin, A Reappraisal of Appraisal Statutes, 38 Mich. L. Rev. 1165, 1181-86 (1940) (describing dissenter and appraisal statutes as being designed to "balanc[e the] interests between the modern corporation with its tremendous powers to make change and the shareholder *who is unwilling to keep his stake in the company* when there is radical change. . . ." (emphasis added)).

73. Manning, supra note 72, at 233-38; Lattin, supra note 72, at 1183-86.

74. R. Clark, Corporate Law 508 (1986). The key to a freezeout merger is the ability of the persons in control of the corporation to adopt a plan of merger that gives them all of the stock in the surviving corporation, and gives cash or other property to those shareholders whom the controlling persons wish to force out. That was not possible until relatively recently; in early corporate law, all shareholders had to be treated equally in the merger. R. Gilson, The Law and Finance of Corporate Acquisitions 869 (1986); Weiss, The Law of Take Out Mergers: A Historical Perspective, 56 N.Y.U. L. Rev. 624, 641-57 (1981). In his famous 1962 criticism of appraisal rights statutes, Professor Manning did not even mention the use of the statutes as a device for protecting shareholders from being squeezed out of the corporation at too low a price. See Manning, supra note 72, at 239-62. Today, that is undoubtedly the more important function of such statutes, and the one that attracts most of the attention both in the courts and in academic writing. See, e.g., Rabkin v. Philip A. Hunt Chem. Corp., 498 A.2d 1099 (Del. 1985); Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983); Singer v. Magnavox, 380 A.2d 969 (Del. 1977); Brudney & Chirelstein, A Restatement of Corporate Freezouts, 87 Yale L.J. 1354 (1978); Greene, Corporate Freezeout Mergers: A Proposed Analysis, 28 Stan. L. Rev. 487 (1976).

else; the terms of the merger plan would call for them to receive cash or other property (other than stock) in exchange for the shares they had formerly held in one of the merging corporations. The minority investors could not remain shareholders in the merged enterprise even if they wanted to. And whatever cash-flow pressure which might arise was actually created by the majority shareholders themselves, as a result of their choosing to force the minority investors to give up their stock in the surviving company. Nevertheless, since the same dissenter's statute applied, the same remedy was available: a minority shareholder who dissented because he did not wish to be forced to accept cash for his stock would find that the statute protected him by giving him the very thing he did not want: cash for his stock.[75] Moreover, all of the complexities and short time periods that had been built into the statute to protect the majority shareholders from minority abuses could now be exploited by the majority to limit the minority's rights to challenge the terms under which the majority had decided to expropriate the minority's stock.

Although the dissenter's statute can still play a potentially important function in protecting a minority shareholder from getting too *little* cash for his stock in a cash-out merger, the short time periods and tricky procedures still contained in this statute are not appropriate for the role that the statute now most frequently plays.[76] These needless traps and complexities work only to deny the minority investors the limited right that they are still supposed to have to challenge the price at which the majority shareholders are expropriating their stock, and they enhance the ability of the majority shareholders to take the minority's shares at any price the majority cares to set.

Under current interpretations of the law, squeezeout mergers allow the persons in control of two-thirds or more of the outstanding stock of a Louisiana corporation to expropriate the shares of the remaining stockholders for a cash payment determined to be "fair" under the dissenters' rights provision.[77] Moreover, the few Louisiana cases that discuss the valuation of a minority investor's stake in a business seem to accept the fact that the majority shareholders ought to be able to carry out this expropriation at a healthy discount off the value that the stock would have on a proportionate basis.[78] The *Armand* case goes

75. La. R.S. 12:131(E) (1969).

76. F. O'Neal & R. Thompson, O'Neal's Oppression of Minority Shareholders, §§ 5:31, 10:08 (2d ed. 1985).

77. McMillan v. Bank of the South, 514 So. 2d 227 (La. App. 5th Cir.), writ denied, 516 So. 2d 131 (1987); Giraud v. Gillis, Ellis & Baker, Inc., 488 So. 2d 1261 (La. App. 4th Cir. 1986).

78. See Shopf v. Marina Del Ray Partnership, 549 So. 2d 833 (La. 1989); *McMillan*, 514 So. 2d 227; Combs v. Howard, 481 So. 2d 179 (La. App. 3d Cir. 1985), writ denied, 484 So. 2d 671 (1986).

one step further, and upholds the power to do that as a means of cutting off a lawsuit brought to enforce the fiduciary duties that the corporation's controlling person was supposed to owe to the corporation for the benefit of all shareholders.[79] The *McCall* decision takes still another step, and holds that all of this can occur without judicial review of the fairness of the price paid in the expropriation if the minority shareholders fail to comply with what amounts to a twenty-day prescriptive period. It would be difficult to design a scheme more unfair to minority investors.

It does make sense to allow some form of involuntary partition action among the co-owners of a business who can no longer get along with one another.[80] Indeed, it makes more sense to handle internal disputes in this way than it does through "fiduciary duty" suits that are purportedly brought in the name and for the benefit of the organization as whole, but which actually serve as vehicles for the resolution of distributional conflicts that courts are ill-equipped to resolve. However, the "partition" procedure that now exists in corporation law is much too heavily skewed in favor of the majority shareholder.[81] The court may have followed the statute in *Armand* and *McCall*, but the statute does not deal with this issue as it should.

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79. Although the court did not consider this issue because of the plaintiffs' loss of their dissenters' rights, it would seem possible even after *Armand* to preserve the fiduciary duty claims as a part of the judicial appraisal proceeding. If the company's value has been affected by the majority shareholder's breaches of fiduciary duty, then it would seem appropriate to adjust the value of the company, and of the shareholder's minority shares, accordingly. See Gabhart v. Gabhart, 267 Ind. 370, 370 N.E.2d 345, 357 (1977). There is also some support outside of Louisiana for the proposition that the merger itself could be enjoined if it could be shown that the merger was being carried out as a means of eliminating the shareholder's derivative suit. Coleman v. Taub, 638 F.2d 628 (3d Cir. 1981); Merritt v. Colonial Foods, Inc., 505 A.2d 757 (Del. Ch. 1986).

80. Brudney & Chirelstein, supra note 74, at 1356 n.9.

81. See supra note 76 and accompanying text.