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Steven J. Willis

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CORPORATIONS, FIDUCIARIES, AND CONFLICTS OF INTEREST

Challenging a liquidator's¹ purchase of property belonging to the corporation being liquidated, plaintiff, a minority shareholder, alleged that the liquidator had breached his fiduciary duties by paying an inadequate price for the property and by manipulating both the plaintiff's stock and the corporation's assets to his own advantage. Plaintiff brought an action to rescind the sale with an alternative demand for damages. In reversing a dismissal by the trial court and an order of rescission by the court of appeal,² the Louisiana Supreme Court awarded damages and *held* that a liquidator who acquires the liquidated corporation's property has the burden of proving that the transaction was fair and at arm's length when made. *Noe v. Roussel*, 310 So. 2d 806 (La. 1975).

Liquidators, by replacing corporate directors,³ acquire the fiduciary obligations imposed upon corporate officers and directors.⁴ Courts have always been suspicious of an agent contracting both for himself and for his principal;⁵ histori-

1. Roussel, the liquidator, owned 99% of the stock of American Benefit Life Ins. Co., which purchased the property. The Louisiana Supreme Court stated, however, that "Roussel is American . . . [A] wholly owned corporation is the alter ego of the party owning the corporation, and . . . in such instances, the corporate veil may be pierced." *Noe v. Roussel*, 310 So. 2d 806, 826 (La. 1975) (emphasis added). Thus, Roussel and American were solidarily liable for any damages Roussel caused. Although the facts of the instant case justify finding the corporation to be Roussel's alter ego, Louisiana courts have not found similarly in *all* matters involving wholly owned corporations. *See, e.g., Texas Industries, Inc. v. Dupuy & Dupuy Dev., Inc.*, 227 So. 2d 265 (La. App. 2d Cir. 1969) (stating that the doctrine of alter ego applies only when the separate individualities of the corporation and its stockholder have ceased to exist).

2. *Noe v. Roussel*, 299 So. 2d 481 (La. App. 4th Cir. 1974).

3. LA. R.S. 12:141(c) (Supp. 1968) provides: "[W]hen the [liquidation] proceeding takes effect . . . all the rights, powers and duties of the officers and board of directors . . . shall be vested in the liquidator . . . and the authority and duties of the officers and directors of the corporation shall cease. . . ."

4. LA. R.S. 12:145(G) (Supp. 1968) provides: "In the performance of his duties, each liquidator shall be bound to exercise that care and prudence in the listing, custody, possession, control and disposition of the property and moneys of the corporation coming into his hands, and in the proper accounting therefor, and distribution thereof, as by law is imposed upon fiduciaries." LA. R.S. 12:91 (Supp. 1968) provides: "Officers and directors shall be deemed to stand in a fiduciary relationship to the corporation and its shareholders and shall discharge the duties of their respective positions in good faith, and with that diligence, care, judgment and skill which ordinary prudent men would exercise under similar circumstances in like position. . . ."

5. *E.g., Pepper v. Litton*, 308 U.S. 295 (1939); *Michoud v. Girod*, 45 U.S. 503, 560 (1846).

cally, most jurisdictions considered the resultant contracts at least voidable by the principal, notwithstanding the fairness of the transaction.⁶ Eventually, however, inherent fairness became the test for determining the validity of such transactions, with courts upholding a contract benefitting a fiduciary upon finding it just and reasonable and holding it voidable otherwise.⁷ In deciding which party has the burden of proving the fairness or unfairness of the transaction, Louisiana courts, in accord with the principles behind the prior standard forbidding such contracts and following the rule in other jurisdictions, have placed the burden of proof upon the party seeking to uphold the transaction.⁸

Recently, a number of states have enacted statutes dealing with the problems of self-dealing, which generally provide criteria for determining the validity of transactions between directors and their corporations.⁹ For example, section 84 of the Louisiana Business Corporation Law¹⁰ provides:

A. No . . . transaction between a corporation and . . . its directors or officers, or between a corporation and any other business . . . or . . . corporation . . . in which one or more of its directors or officers are directors or officers or

6. See Marsh, *Are Directors Trustees?*, 22 THE BUS. LAWYER 35 (1966) [hereinafter cited as Marsh]. See, e.g., R. POTHIER, *TRAITE DU CONTRAT DE VENTE*, pt. 1, n° 13 (1806): "Nous ne pouvons acheter, ni par nous-mêmes, ni par personnes interposées, les choses que font parties des biens dont nous avons l'administration; ainsi un tuteur ne peut acheter les choses qui appartiennent à son mineur; un administrateur ne peut acheter aucune chose de bien dont il a l'administration . . ."

7. Marsh at 43.

8. *E.g.*, *House of Campbell v. Campbell*, 172 So. 2d 727, 730 (La. App. 2d Cir. 1965) ("the director has the burden of proof of fairness to the corporation and that he was acting in good faith"). See, e.g., *Pepper v. Litton*, 308 U.S. 295 (1939); *Geddes v. Anaconda Copper Mining Co.*, 254 U.S. 590, 599 (1921); *Remillard Brick Co. v. Remillard-Dandini Co.*, 109 Cal. App. 2d 405, 241 P.2d 66 (1952).

9. CAL. CORP. CODE § 820 (1947); CONN. GEN. STAT. 33-323 (1959); DEL. CODE 8:144 (1969); GA. CODE 22:716 (1968); IND. STAT. 23-1-10-6 (1969); KAN. STAT. 17-6304 (1972); KY. R.S. 271A.205 (1972); LA. R.S. 12:84 (Supp. 1968); ME. R.S. 13A:717 (1971); MICH. STAT. 15:21.200(545) (1973); NEB. R.S. 21-2040.01 (1972); NEV. R.S. 78.140 (1969); N.J. STAT. 14A:6-8 (1968); N.Y. BUS. CORP. LAW § 713 (1963); N.C. GEN. STAT. 55-30 (1955); PA. STAT. 15:1409.1 (1968); R.I. GEN. LAWS 7-1.1-37.1 (1969); S.C. CODE 12-18.16 (1962); TENN. CODE 48-816 (1968); VA. CODE 13:1-39.1 (1975); W. VA. CODE 31-1-97 (1974); WIS. STAT. 180.355 (1972). MODEL BUS. CORP. ACT § 41 (1969) served as the model for most of the statutes.

10. LA. R.S. 12:84 (Supp. 1968).

have a financial interest, shall be void or voidable solely for this reason . . . if:

(1) The material facts as to his interest and as to the contract or transaction were disclosed or known to the board of directors or the committee, and the board or committee in good faith authorized the contract or transaction by a vote sufficient for such purpose without counting the vote of the interested director or directors; or

(2) The material facts as to his interest and as to the contract or transaction were disclosed or known to the shareholders entitled to vote thereon, and the contract or transaction was approved in good faith by vote of the shareholders; or

(3) The contract or transaction was fair as to the corporation as of the time it was authorized, approved or ratified by the board of directors, committee, or shareholders

The comments to the corresponding provision in the Model Business Corporation Act,¹¹ which section 84 closely follows, reveal an intent to modify the strict judicial scrutiny formerly given such transactions by "validat[ing], if the prescribed tests are satisfied, transactions with interested directors which common law rules often make voidable if not void."¹²

Despite the comments accompanying the Model Act, questions have arisen whether and to what extent a more lenient standard has actually been enacted. Some commentators, citing the lack of specification in typical state statutes concerning which party bears the burden of proving whether the tests have been met, have wondered if the leniency has gone as far as shifting the burden of showing unfair dealing to the plaintiff.¹³ Furthermore, although the Model Act and those statutes based upon it are written in the disjunctive, indicating only one of the three conditions need be met to uphold the transaction, debate continues on whether disclosure of the conflict accompanied by stockholder or director approval is alone adequate, or whether the transaction need *always* be proved fair.¹⁴

11. MODEL BUS. CORP. ACT § 41 (1969).

12. MODEL BUS. CORP. ACT ANN. 2d at 842 (1971).

13. Kessler, *The N.Y. Bus. Corp. Law*, 36 ST. JOHN L. REV. 1, 74-77 (1961); Note, 16 BUFF. L. REV. 840, 842 (1967).

14. Compare Canard, *An Overview of the Laws of Corporation*, 71 MICH.

In the instant case, the corporate liquidator acted in bad faith¹⁵ by manipulating the minority shareholder's stock and paid an inadequate price for the property he purchased from the corporation.¹⁶ The Louisiana Supreme Court emphasized that a liquidator's fiduciary obligation extends not only to the corporation, but also to the individual stockholders;¹⁷ additionally, the court held the liquidator to the standards required of a corporate director, whom he replaces, when dealing with the corporation.¹⁸ In construing section 84 of the Louisiana Corporation Law, the court concluded that an interested liquidator bears the burden of proving the fairness and impartiality of any transaction he conducts with the corporation.¹⁹ The court went beyond the facts of the instant case to state that *any* agent or other person acting in a fiduciary capacity who acquires his principal's property bears the burden of proving the fairness of the transaction. In describing the extent of that burden, the court said:

L. REV. 623, 653-54 (1973) (arguing that judges must continue to require a fair transaction, especially in light of stockholder giveaways) *with* Note, 16 BUFF. L. REV. 840, 845 (1967) (supporting a more lenient provision allowing for validity of transaction involving interested directors upon full disclosure and independent approval, notwithstanding unfairness). *See also* Remillard Brick Co. v. Remillard-Dandini Co., 109 Cal. App. 2d 405, 418, 241 P.2d 66, 74 (1952) in which the court said that "neither section 820 of the Corporations Code nor any other provision of the law automatically validates such transactions simply because there has been a disclosure and approval by the majority of the stockholders Even though the requirements of section 820 are technically met, transactions that are unfair and unreasonable to the corporation may be avoided." *See* Marsh at 74 for a proposed amendment to the Securities Exchange Act of 1934 to forbid *any* corporate transaction with an affiliated person.

15. The liquidator arranged for plaintiff's stock to be listed in the name of another person, without plaintiff's consent, called all of plaintiff's preferred stock the day after suit was filed, and, in his attempt to sell the corporate assets, used an advertisement the court determined was "[t]o say the least . . . misleading." 310 So. 2d at 819.

16. Although the Louisiana Supreme Court treated Roussel, the liquidator, as the purchaser, American Benefit Life Ins. Co., his alter ego, was the actual vendee.

17. Under LA. R.S. 12:91 (Supp. 1968), corporate directors owe fiduciary duties to the stockholders. LA. R.S. 12:145(G) (Supp. 1968) does not specifically extend fiduciary obligations from liquidators to stockholders, but because the court analogizes their responsibility to that of corporate officers, liquidators are now also subject to individual shareholder action in addition to derivative actions under LA. R.S. 12:42 (Supp. 1968).

18. 310 So. 2d at 816.

19. *Id.* at 818-19.

[such a person] bears the burden of establishing that the transaction was an arm's length affair. This means that the agent or fiduciary must handle the matter as though it were his own affair. It also means the agent or fiduciary may not take even the slightest advantage, but must zealously, diligently and honestly guard and champion the rights of his principal against all other persons whomsoever, and is bound not to act in antagonism, opposition or conflict with the interest of the principal to even the slightest extent.²⁰

By placing the burden of proving the fairness of the transaction upon the fiduciary,²¹ Louisiana adheres to the traditional rule grounded upon the suspicions inevitably aroused by transactions in which those exercising the serious responsibility of fiduciaries act also for their own benefit. The court did not rely upon section 84 which, along with the similar statutes of other states, fails to indicate who bears the burden when corporate self-dealing is challenged; rather, the court looked to prior jurisprudence²² finding such transactions marked with a presumption of fraud. Although requiring the party seeking to uphold such a transaction to dispel the doubts which naturally exist is not a novel result,²³ realization that placement of the burden of proof frequently determines the outcome in cases involving complex factual situations emphasizes the importance of the court's clarification of the evidentiary issue.

Further importance of *Noe* lies in the court's strong indication in the decision that Louisiana has rejected the tendency of its sister states to adopt more lenient policies concerning conflicts of interest,²⁴ evidenced by the extensive ob-

20. *Id.*

21. Although the plaintiff in this case showed conduct by the defendant in violation of his fiduciary responsibilities, the court clearly indicated that the plaintiff need not have done this, since the burden was upon the fiduciary to refute the presumption of fraud which was automatically raised by the conflict of interest. 310 So. 2d at 818. *See, e.g., Cuggy v. Zeller*, 132 La. 222, 61 So. 209 (1913).

22. *Pepper v. Litton*, 308 U.S. 295 (1939); *Mason v. Pewabic Mining Co.*, 133 U.S. 50 (1890); *Jackson v. Ludeling*, 88 U.S. 616 (1874); *Michoud v. Girod*, 45 U.S. 503 (1846); *Assunto v. Coleman*, 158 La. 537, 104 So. 318 (1925); *Cuggy v. Zeller*, 132 La. 222, 61 So. 209 (1913); *House of Campbell v. Campbell*, 172 So. 2d 727 (La. App. 4th Cir. 1965).

23. See cases cited in H. HENN, *LAW OF CORPORATIONS* 2D ED. 467 n.8 (1965).

24. See text at note 12, *supra*. Several legislatures which adopted stat-

ligations the court places upon corporate fiduciaries. Liking the liquidator's responsibilities to those of corporate officers and directors, the court cites section 84 as support for its delineation of those obligations.²⁵ Without mentioning the statute's disjunctive form, which seemingly grants approval if the transaction meets the test of either fairness or full disclosure accompanied by independent approval, *Noe* requires fairness in all cases, notwithstanding full disclosure, in addition to an arm's length deal.²⁶

Justification for the court's construction of the statute might lie in the part of section 84 which provides that the relevant transaction is not void or voidable solely because it involves a fiduciary acting both for himself and for his principal if one of the enumerated tests is satisfied. Even if one, or all, of those tests are met, the transaction might still be voidable for another reason—the most likely being a violation of the fiduciary's obligation to act in good faith.²⁷ In so deciding, Louisiana becomes part of a distinct minority, California being the only other state to have similarly held that, in conflict of interest cases, provisions such as section 84 only supplement, rather than replace, the overriding fiduciary obligation imposed upon directors and liquidators.²⁸

utes similar to LA. R.S. 12:84 (Supp. 1968) apparently had the intention of adopting a more lenient rule than that which developed under their respective jurisprudence. MICH. STAT. ANN. 15:21.200 (545) Revision Comment (1973); N.J. STAT. ANN. 14A:6-8 Commissioners' Comment (1968); 6 MCKINNEY'S CONSOLIDATED LAWS OF N.Y. ANN. at 639, N.Y. BUS. CORP. LAW § 713, Legislative Studies & Reports (1963).

25. 310 So. 2d at 817.

26. Although one might suppose that full disclosure accompanied by independent approval would satisfy the arm's length requirement, the California appellate court in *Remillard Brick Co. v. Remillard-Dandini Co.*, 109 Cal. App. 2d 405, 241 P.2d 66 (1952), states that it would not, as the fiduciary must also prove that he acted in good faith. The Louisiana Supreme Court seems to agree when it requires that the fiduciary prove he zealously championed the rights of his principal and did not act in conflict with the interest of the principal to even the slightest extent.

27. LA. R.S. 12:91 (Supp. 1968); LA. R.S. 12:145(G) (Supp. 1968).

28. See CAL. CORP. CODE 820 which includes the director's obligation to act in good faith. In *Remillard Brick Co. v. Remillard-Dandini Co.*, 109 Cal. App. 2d 405, 241 P.2d 66 (1952), the California appellate court relied upon this obligation and upon the statement that a transaction with an interested director is not void or voidable solely because of the conflict of interest. The court said: "It would be a shocking concept of corporate morality to hold that because the majority directors or stockholders disclose their purpose and interest, they may strip a corporation of its assets to their own financial advantage, and that the minority is without legal redress." 109 Cal. App. 2d at 418-19, 241 P.2d at 74.

Thus the Louisiana Supreme Court clarifies section 84 by indicating that disclosure accompanied by independent approval is not enough: the fiduciary must also act in good faith and in a fair manner. The court describes the standard of care as that of an agent handling his own affairs.²⁹ Left unanswered, however, are questions of how future courts will apply the *Noe* standard to different situations, particularly those in which an interested fiduciary pays or charges a fair price but does so with a selfish motive. For example, if a director were involved in a competing business and, seeking to stifle competition, purchased the principal corporate assets, he would clearly violate his obligation to act at arm's length. Similarly, he would violate the *Noe* standard if he sold to the corporation at a fair price something unnecessary. In each situation a stockholder may be harmed because the corporation no longer has the assets upon which he relied or is not being operated in the manner he expected, but he still may have difficulty proving actual monetary damages. *Noe* suggests that rescission would ordinarily be the proper remedy for such a violation of the arm's-length test,³⁰ irrespective of whether the price was fair, the conflict disclosed, or the transaction approved, unless the interested fiduciary could

29. 310 So. 2d at 818-19. However, LA. R.S. 12:91 (Supp. 1968), upon which the court relies, uses the test of a prudent man under similar circumstances *in like positions*. There is a split among jurisdictions on whether to use the standard of an "ordinary man" or of an "ordinary director." H. HENN, *LAW OF CORPORATIONS* 2D ED. at 454-55 (1965).

30. The Louisiana Supreme Court quoted *Pepper v. Litton*, 308 U.S. 295 (1939), in which the United States Supreme Court said: "The essence of the test is whether or not under all the circumstances the transaction carries the earmarks of an arm's length bargain. If it does not, equity will set it aside." 308 U.S. at 306. The Louisiana Supreme Court implies that an arm's length deal is something more than a fair deal—it encompasses the motive and degree of good faith of the fiduciary. Since the defendant extensively violated his duty to act in good faith, even if the price he paid had been fair, the plaintiff may still have had an action under LA. R.S. 12:91 (Supp. 1968) (see note 4, *supra*) and under the standard of care required of fiduciaries as announced by *Noe*. The court did not rescind the sale, however, since the property had been transferred to a "third party in good faith" prior to the filing of a *lis pendens* by plaintiff. Hoping to protect the public records doctrine, numerous banking, financial, and commercial institutions filed *amicus curiae* briefs urging the Supreme Court to overrule the court of appeal, which had rescinded the sale notwithstanding the transfer to the third party. They reasoned that even though the transferee was a subsidiary of American Benefit Life Ins. Co., the liquidator's alter ego, the court should not pierce the corporate veil since the transferee was a non-litigant and had purchased the property without notice of the pending action.

meet the heavy burden of proving that he acted without any selfish motive or conflict of interest to even the slightest extent.³¹ Allowing such wronged minority stockholders a remedy is not objectionable; however, applying the burden of proof rule in *Noe* might have the effect of precluding transactions by interested directors altogether, a policy most jurisdictions abandoned years ago.

Ambiguity in the existing Louisiana statutes provides some support for the court's rejection of the more lenient rules concerning conflicts of interest and adoption of a perhaps too stringent standard. Thus perhaps the legislature should consider amending section 84 to clearly state that a director must always act in good faith and that he must always pay or charge a fair price in any transaction he conducts with the corporation.³² Additionally, codification of the *Noe* burden concerning proof of compliance with the statutory tests could be joined with a provision which would enable a director to relieve himself of that burden, shifting it to the party challenging the transaction, if, in advance, he fully discloses his conflict of interest and obtains independent approval of the proposed transaction from either the stockholders or from the board of directors.³³ Such a statute would clearly protect minority shareholders, and concurrently, relieve directors and liquidators of the unjustifiably heavy burden now placed upon them.

Steven J. Willis

31. The court does not explain how a fiduciary can act both for himself and for his principal *without* having a conflict of interest.

32. Such an amendment would incorporate the requirements of section 84(A)(3), the fairness test, and of section 91 of the Louisiana Corporation Law, which establishes the general fiduciary obligation, making them of overriding importance.

33. Thus amended, the statute would retain sections (a)(1) and (a)(2) of L.A. R.S. 12:84 (Supp. 1968), which provide for full disclosure of the conflict and independent approval, and make them significant only to the placement of the burden of proof, rather than to the ultimate validity of the transaction.