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Corporations

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STUDENT CONTRIBUTION

CORPORATIONS

The public perceives the typical corporation as a large publicly-owned conglomerate. However, most corporate activity actually is conducted through small closely-held companies.[1] The corporate continuum extends from the incorporated sole proprietorship to the diversified multinational corporation. Notwithstanding the dichotomy of corporate form, the judicial system applies the same set of legal precepts to both ends of the spectrum. This judicial myopia may lead to pernicious case decisions; however, some courts have begun to restructure their judicial analysis to compensate for legislative inadequacies.[2] This emerging judicial reorientation centers on a recognition of the similarities between the small closely-held corporation and the partnership entity.[3]

Close corporations are unique primarily because of the personal, intimate, on-going association of the shareholders. This relationship gives rise to shareholder expectations which may include their participation in management, long-term employment, and periodic dividend distributions. These bargained-for expectations of shareholders in a close corporation rarely are outlined in the corporate by-laws. The parties' true intent "may not even be in writing but may have to be construed from their actions."[4] Some of the legal disputes decided

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1. The definition of a closely-held corporation tends to vary among academicians. For a discussion of the various views on the limits of "closely-held," see Soderquist, *Reconciling Shareholders' Rights and Corporate Responsibility: Close and Small Public Corporations*, 33 VAND. L. REV. 1387, 1391 (1980). *See, e.g.*, Donahue v. Rodd Electrotype Co., 367 Mass. 578, 328 N.E.2d 505 (1975).

2. Hetherington & Dooley, *Illiquidity and Exploitation: A Proposed Statutory Solution to the Remaining Close Corporation Problem*, 63 VA. L. REV. 1, 7 (1977). The jurisprudence recognizes that an equity court can order dissolution of a solvent corporation independent of statutory authority for such action. *See* Bellevue Gardens, Inc. v. Hill, 297 F.2d 185 (D.C. Cir. 1961); Bailey v. Proctor, 160 F.2d 78 (1st Cir.), *cert denied*, 331 U.S. 834 (1947); Miner v. Belle Isle Ice Co., 93 Mich. 97, 53 N.W. 218 (1892); Leibert v. Clapp, 13 N.Y.2d 313, 196 N.E.2d 540, 247 N.Y.S.2d 102 (1963).

3. *See, e.g.*, Nelkin v. H.J.R. Realty Corp., 25 N.Y.2d 543, 255 N.E.2d 713, 307 N.Y.S.2d 454 (1969); Kruger v. Gerth, 16 N.Y.2d 802, 210 N.E.2d 355, 263 N.Y.S.2d 1 (1965) (Fuld, J., dissenting); Weiss v. Gordon, 32 A.D.2d 279, 301 N.Y.S.2d 839 (1969).

4. Topper v. Park Sheraton Pharmacy, Inc., 107 Misc. 2d 25, 33, 433 N.Y.S.2d 359, 365 (Sup. Ct. 1980). An arbitrary application of the "majority rule" concept often deviates from the true expectations of the parties.

> Not uncommonly a participant in a closely held enterprise invests all his assets in the business with an expectation, often reasonable under the circumstances even in the absence of an express contract, that he will be a key employee in the company and will have a voice in business decisions. When courts apply the

by the Louisiana courts in the past year may be characterized as involving shareholder expectations.[5] The shareholders' anticipated business association is subject to change as the enterprise develops. A judicial solution to close corporation problems should favor equitable considerations over strict legal analysis of the legislative remedies; otherwise, the majority shareholders are free to exploit the minority interest solely for their own benefit.[6]

Some legal theoreticians contend that close corporations are indistinguishable from their publicly-traded counterparts and refuse to recognize a legal dichotomy between closely-held and publicly-owned corporations. The proponents of this thesis maintain that the shareholders can set up contractual arrangements in anticipation of necessitous circumstances.[7] However, those stockholders who fail to bargain for and obtain protective contractual arrangements must resort to the state's statutory framework.[8] Professor O'Neal has observed that

> [a]s minority participants in a close corporation may not anticipate dissension or oppression, and indeed may be unaware of their vulnerability, they frequently fail to bargain for adequate protection against mistreatment. In view of this widespread failure of minority shareholders to use self-help, commentators and legislative draftsmen might well turn their attention to ways of providing automatic statutory protection.[9]

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principle of majority rule in close corporations, they often disappoint the reasonable expectations of minority participants.

O'Neal, *Close Corporations: Existing Legislation and Recommended Reform*, 33 BUS. LAW. 873, 884 (1978). *See also* Exadaktilos v. Cinnaminson Realty Co., 167 N.J. Super. 141, 400 A.2d 554 (Law Div. 1979), and text at note 45, *infra*.

5. See text at notes 12-45, *infra*.

6. O'Neal, *supra* note 4, at 887.

7. This alternative is both useful and well-used. However, the contractual option as a solution to closely held corporation problems is really somewhat of a paradox.

> The emphasis on contractual arrangements reveals a fundamental misunderstanding of the nature of close corporations. Whether the parties adopt special contractual arrangements is much less important than their ability to sustain a close, harmonious relationship over time. The continuance of such a relationship is crucial because it reflects what is perhaps the fundamental assumption made by those who decide to invest in a close corporation: they expect that during the life of the firm the shareholders will be in substantial agreement as to its operation.

Hetherington & Dooley, *supra* note 2, at 2. *See* the authorities cited in note 4, *supra*.

8. The need for adequate self-executing protection for minority shareholders has been recognized by a few states. See note 23, *infra*. Where the shareholder has failed to contractually protect himself and state law is insensitive to his needs, the courts are often unable to provide a remedy. This is at least a partial, if not complete, explanation for the incongruous outcome in Streb v. Abramson-Caro Clinic, 401 So. 2d 410 (La. App. 1st Cir.), *writ denied*, 403 So. 2d 69 (La. 1981). See text at notes 12-45, *infra*.

9. O'Neal, *supra* note 4, at 881-82. For a progressive example of state legislation protecting minority rights, see S.C. CODE ANN. § 33-21-155 (Law. Co-op. Supp. 1981).

The Louisiana statutory framework appears to be inadequate for the protection of shareholders in a close corporation.[10] Moreover, the deficiencies of Louisiana corporate law are not only restricted to shareholder inequities but also extend to creditors.

Although numerous cases[11] in the corporate area have been litigated in the past year, only three appellate decisions clearly highlight the conflicts between general corporate law and the problems uniquely inherent in a closely-held corporation. The first case involves the oppression of minority interests, the second one addresses the rights of creditors when a corporation becomes insolvent, and the third decision briefly examines the authority of officers and directors to contract for the corporation. All three decisions are discussed and analyzed in the context of a close corporation, a setting which often precludes the application of general corporate principles.

The Oppression of Minority Shareholders

Streb v. Abramson-Caro Clinic[12] illustrates a situation where the court's overreliance on the doctrine of majority rule[13] precluded their granting relief to an oppressed shareholder. The plaintiff in *Streb* and two other doctors formed a professional medical corporation; dissension and friction subsequently followed, culminating in the removal of the plaintiff from the board of directors and the termination of his employment with the corporation. The plaintiff prayed for a judicial or involuntary dissolution[14] of the corporation. Both the district court and the first circuit concluded that the excluded doctor had failed to state a cause of action for involuntary dissolution.[15]

The actions of the majority shareholders resulted in an effective

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10. The corporate statutory scheme seems more attuned to large publicly-owned corporations. *See, e.g.*, LA. R.S. 12:143 (Supp. 1968, 1970 &1976). *But see* LA. R.S. 12:151(A)(5) (Supp. 1968).

11. *See, e.g.*, DeFelice v. Garon, 395 So. 2d 658 (La. 1980) (voting trust agreement); Donnelly v. Handy, 415 So. 2d 478 (La. App. 1st Cir. 1982) (officer's personal liability for tortious conduct); Hamm v. Southeast La. Emergency Medical Serv. Council, Inc., 414 So. 2d 835 (La. App. 4th Cir. 1982) (officer's authority to contract); Groves v. Rosemound Improvement Ass'n, Inc., 413 So. 2d 925 (La. App. 1st Cir. 1982) (voting rights of shareholders); Southern-Gulf Marine Co. No. 9, Inc. v. Camcraft, Inc., 410 So. 2d 1181 (La. App. 3d Cir. 1982) (corporate capacity to contract); Fireplace Shop, Inc. v. Fireplace Shop of Lafayette, Inc., 400 So. 2d 702 (La. App. 1st Cir. 1981) (appointment of a receiver).

12. 401 So. 2d 410 (La. App. 1st Cir.), *writ denied*, 403 So. 2d 69 (La. 1981).

13. *See* the authorities cited in note 4, *supra*, and text at note 45, *infra*.

14. *See* LA. R.S. 12:143 (Supp. 1968, 1970 & 1976).

15. The court remanded the case because it perceived the possibility that the plaintiff could amend his pleadings so as to be entitled to some relief. 401 So. 2d at 414. A conceivable remedy for the plaintiff might exist under LA. R.S. 12:161 (Supp. 1968). *See also* LA. R.S. 12:905(B) (Supp. 1979).

"freeze-out"[16] of the minority shareholder's interest. Because of the lack of a readily available market for the corporate stock,[17] the plaintiff could be afforded complete relief only by a dissolution of the corporation. Commentators have recognized that the dissolution of an on-going, profitable[18] business entity is a drastic remedy.[19] This cautious trepidation originates in the judiciary's failure to treat closely-held corporations as comparable to partnerships.[20]

> When applied to publicly held corporations, corporate law generally functions adequately to protect all interests. However, the same law, when applied to close corporations, is not equally efficacious.
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> The lack of special treatment for close corporations, either statutory or judicial, results in a number of situations in which minority shareholders are oppressed and squeezed-out by a scheming majority. Traditional corporate law tends to limit judicial intervention only to those situations involving the most egregious conduct.[21]

A remedy for the preclusion of minority rights is acknowledged and supported by the judiciary of all states. As such, the Louisiana judiciary should formulate an adequate remedy until our legislature fills the statutory void. The *Streb* court's analysis was correct, but the functional accuracy of its analysis was undermined by the court's failure to provide any relief.

In the early 1960's, some state courts began to take a renewed

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16. *See* F. O'NEAL, OPPRESSION OF MINORITY SHAREHOLDERS (1975); F. O'NEAL & J. DERWIN, EXPULSION OR OPPRESSION OF BUSINESS ASSOCIATES (1961).

17. 401 So. 2d at 413.

18. The presence or absence of a positive net income should not deter a court from applying the appropriate remedy. *See* Comment, *Relief to Oppressed Minorities in Close Corporations: Partnership Precepts and Related Considerations*, 1974 ARIZ. ST. L.J. 409, 424; *see also* Chayes, *Madame Wagner and the Close Corporation*, 73 HARV. L. REV. 1532, 1546 (1960). Furthermore, the practical effect of most remedies for oppressed minorities leaves the enterprise intact. The firms which are liquidated "are those that neither the majority nor anyone else finds sufficiently profitable to continue. Firms in that category can hardly be described as 'viable,' and their passing will not occasion any social cost." Hetherington & Dooley, *supra* note 2, at 50.

19. "The two principal conceptual barriers to the courts' granting relief to aggrieved minority shareholders—the principle of majority rule in corporate management and the business judgment rule—actually have only limited validity in small business corporations." O'Neal, *supra* note 4, at 884. *See generally* Soderquist, *supra* note 1, at 1410-13; Comment, *supra* note 18, at 414-15; Note, *Close Corporations: Strict Good Faith Fiduciary Duty Applied to Controlling Stockholders*, 38 LA. L. REV. 214, 216-17 (1977).

20. *See* authorities cited at note 3, *supra*. *But see* Baker v. Commercial Body Builders, Inc., 260 Or. 614, 507 P.2d 387 (1973); Jackson v. Nicolai-Neppach Co., 219 Or. 560, 348 P.2d 9 (1959).

21. Comment, *supra* note 18, at 413. *See* F. O'NEAL, 1 CLOSE CORPORATIONS: LAW AND PRACTICE §§ 3.03, 3.04, 3.06, 5.05 (2d ed. 1971).

approach to minority relief and the traditional concepts of involuntary dissolution.[22] As a result, state legislatures adopted specific reforms to remedy the corporate preclusion of minority interests.[23] The majority of these statutes contain provisions which prohibit the directors or those in control of a corporation from acting "in a manner that is illegal, oppressive, fraudulent, or unfairly prejudicial"[24] to any shareholder. To date, Louisiana has not adopted an equivalent legislative proposal. The inordinate result in *Streb* suggests the need for legislative amelioration of the consequences. Judicial interpretations in states which proscribe these activities provide testamentary proof of the economic necessity and functional workability of such statutes.

In a situation like *Streb*, a court relying on an "oppression-type" statute[25] understandably could conclude that the conduct of the majority was oppressive.[26] Oppression, in and of itself, is an independent ground for relief which does not require a showing of fraud, illegality, mismanagement, or wasting of assets.[27] A definition of oppression and conduct which meets its criteria is difficult to articulate. A general consensus adumbrates that oppression can be characterized as a lack of probity and fair dealing in the affairs of the enterprise to the prejudice of some portion of its members.[28] Commentators repeatedly have recognized that

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22. *See, e.g.*, Gidwitz v. Lanzit Corrugated Box Co., 20 Ill. 2d 208, 170 N.E.2d 131 (1960); Central Standard Life Ins. Co. v. Davis, 10 Ill. 2d 566, 141 N.E.2d 45 (1957); Polikoff v. Dole & Clark Bldg. Corp., 37 Ill. App. 2d 29, 184 N.E.2d 792 (1962); *see also* Fix v. Fix Material Co., 538 S.W.2d 351 (Mo. Ct. App. 1976), and the authorities cited in note 2, *supra*.

23. *See* CAL. CORP. CODE § 1800 (West 1977); ILL. ANN. STAT. ch. 32, § 157.86(a)(3) (Smith-Hurd Supp. 1982); MD. CORPS. & ASS'NS CODE ANN. § 4-603 (1975); MICH. COMP. LAWS ANN. § 450.1825 (1978); MINN. STAT. ANN. § 302A.75(b)(2) (West 1981); MO. ANN. STAT. § 351.485 (Vernon Supp. 1982); N.J. STAT. ANN. § 14A:12-7 (West Supp. 1982); N.Y. BUS. CORP. LAW § 1104 (McKinney 1963); R.I. GEN. LAWS § 7-1.1-90 (1970); S.C. CODE ANN. § 33-21-155 (Law. Co-op Supp. 1981); W. VA. CODE § 31-1-134 (1982). *See also* Committee on Corporate Laws, *Proposed Statutory Close Corporation Supplement to the Model Business Corporation Act*, 37 BUS. LAW. 269, 299-306 (1981).

24. Committee on Corporate Laws, *supra* note 23, at 300 (quoting the proposed supplement to Model Business Corp. Act § 16(a)(1)).

25. *See* the statutes cited in note 23, *supra*.

26. *But see* Exadaktilos v. Cinnaminson Realty Co., 167 N.J. Super. 141, 400 A.2d 554 (Law Div. 1979); Baker v. Commercial Body Builders, Inc., 264 Or. 614, 507 P.2d 387 (1973).

27. *See* Compton v. Harding Realty Co., 6 Ill. App. 3d 488, 285 N.E.2d 574 (1972).

28. *See* Fix v. Fix Material Co., 538 S.W.2d 351 (Mo. Ct. App. 1976); Baker v. Commercial Body Builders, Inc., 264 Or. 614, 507 P.2d 387 (1973); White v. Perkins, 213 Va. 129, 189 S.E.2d 315 (1972). Oppression has been defined in the English Companies Act as "a visible departure from the standards of fair dealing, and a violation of the conditions of fair play on which every shareholder who entrusts his money to a company is entitled to rely." Elder v. Elder & Watson, Ltd., 1952 Sess. Cas. 49, 55 (Scot.), *quoted in Fix*, 538 S.W.2d at 358.

> [c]ircumstances which may give rise to "oppression" are "so infinitely various that it is impossible to define them with precision." It might be added, moreover, that any attempt to define "oppressive" would tend to reduce the flexibility of the provision. "Oppressive" is no less vague or abstruse than "fiduciary duty" or "trust relationship," phrases which have been productively employed.[29]

The initial judicial analysis involves a juxtaposition of the factual background against the judicial policy outlines of oppressive conduct. The plaintiff in *Streb* alleged that his removal would occasion financial hardship not only because of the termination of his employment but also because of the loss of accrued pension benefits and uncollected accounts receivable.[30] Hence, in *Streb*, expulsion by majority vote allegedly resulted in long-term economic distress. The courts' reluctance to dissolve the entity arose from the perceived lack of statutory authorization;[31] however, the lack of legislative approval should not prevent a court from protecting and enforcing shareholder rights.

A judicious evaluation of the relationship between directors and shareholders can protect shareholder's rights. Directors and majority shareholders are deemed to stand in a fiduciary relationship to the minority shareholders.[32] This relationship in a close corporation has been qualified as more akin to that of partners than to corporate stockholders.[33] Furthermore, at least one state court has opined that cases involving the fiduciary duty owed by directors and majority stockholders vis-a-vis the minority embrace the same standard which other courts have evolved under the term "oppressive conduct."[34] Using a similar analysis under the *Streb* facts would allow a court to impose the equitable remedy of dissolution upon concluding that the majority shareholders had breached the fiduciary duty owed to

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29. Comment, *Oppression as a Statutory Ground for Corporate Dissolution*, 1965 DUKE L.J. 128, 140-41; *see* the authorities cited in note 28, *supra*.

30. 401 So.2d at 412-13.

31. *See* the authorities cited in note 2, *supra*.

32. *See, e.g.*, Mardel Securities, Inc. v. Alexandria Gazette Corp., 320 F.2d 890 (4th Cir. 1963); Mims v. Valley Nat'l Bank, 14 Ariz. App. 190, 481 P.2d 876 (1971); Galler v. Galler, 95 Ill. App. 2d 340, 238 N.E.2d 274 (1968); Fix v. Fix Material Co., 538 S.W.2d 351 (Mo. Ct. App. 1976); Zidell v. Zidell, Inc., 277 Or. 413, 560 P.2d 1086 (1977); Seaboard Indus., Inc. v. Monaco, 442 Pa. 256, 276 A.2d 305 (1971). There is no justification for the concept that the fiduciary duty flows only to the corporation and not to the minority shareholders. In close corporations, the only utility of the corporate fiduciary duty concept is the control of abusive self-dealing and fraudulent misappropriation of assets. Adelman v. Conotti Corp., 215 Va. 782, 213 S.E.2d 774 (1975); Cain v. Cain, 334 N.E.2d 650 (Mass. App. Ct. 1975). In all other situations in close corporations, the firm's interest is the "alter ego" of the majority's interest.

33. *See* the authorities cited in note 3, *supra*.

34. *See* Masinter v. Webco Co., 262 S.E.2d 433, 440 (W. Va. 1980).

the minority shareholders.[35] Although this indirect approach seems contrary to the statutory basis of dissolution,[36] it has been sanctioned in other jurisdictions[37] and ostensibly would be permissible in Louisiana as well.

When the court concludes that the minority shareholders have been oppressed by the squeeze-out technique, they need only apply the proper remedy. The plaintiff in oppression-type cases generally seeks judicial dissolution of the corporate enterprise, but dissolution is not a panacea for shareholder dissension. Fortunately, the number of remedies available to a court far exceed the singular remedy of corporate death.[38] This is not to say that dissolution is inherently disadvantageous. In involuntary dissolution cases, the courts assume that a decree will result in the termination of the business.[39] The judicial reluctance to grant dissolution springs from the perceived public interest in continuing profitable firms. The concern of the courts is misplaced because of their misconception of the ultimate effect of a dissolution decree.

> In practical effect a decree is no different than the dissolution of a partnership. The entry of a decree results in the termination of the business only if both the majority and the minority shareholders desire that result. Each faction has the ability at any stage of the proceeding to insure the continued existence of the firm by buying out, or selling out to, the other faction. The

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35. *See generally* Petrick v. B-K Dynamics, Inc., 283 A.2d 696 (Del. Ch. 1971); Keck v. Schumacher, 198 So.2d 39 (Fla. Dist. Ct. App. 1967); Holden v. Construction Mach. Co., 202 N.W.2d 348 (Iowa 1972); Wilkes v. Springside Nursing Home, Inc., 370 Mass. 842, 353 N.E.2d 657 (1976); Ruetz v. Topping, 453 S.W.2d 624 (Mo. App. Ct. 1970); Note, *supra* note 19.

36. LA. R.S. 12:143(A) (Supp. 1968). At least one commentator views the contractual relationship of close corporation shareholders as including the right of recession. The minority is said to have a right to rescind the agreement if the majority has failed to comply with the contract, *i.e.*, to operate the business in the best interests of *all* participants. Comment, *Minority Dissolution of the Close Corporation*, 35 GEO. WASH. L. REV. 1068, 1079 (1967); *see also* Hornstein, *A Remedy for Corporate Abuse-Judicial Power to Wind Up a Corporation at the Suit of a Minority Stockholder*, 40 COLUM. L. REV. 220 (1940).

37. *See* the authorities cited in notes 3, 23 & 35, *supra*.

38. See text at note 19, *supra*. The existence of the dissolution remedy may be just as helpful as its actual use.

> If dissolution is denied . . . a settlement is perhaps less likely to occur, at least initially. Having failed in his effort to compel the defendant to buy him out . . . the petitioner's bargaining position becomes much weaker. After successfully resisting the challenge to his control, the defendant now has no more, and probably less, reason to purchase the petitioner's interest than he had before the suit was brought.

Hetherington & Dooley, *supra* note 2, at 28.

39. Hetherington & Dooley, *supra* note 2, at 27.

> business will cease only if continuing it is not in the interest of any of its shareholders.[40]

Nonetheless, most courts have concluded that the interminable consequences of dissolution require that less onerous alternatives be employed.[41] Commensurate with this judicial policy, many states now have recognized that a dissolution statute does not provide the exclusive remedy for injured shareholders; equity may require the court to fashion a more appropriate remedy.[42] For example, some states have enacted legislation that grants a court the power to appoint a custodian to run a close corporation if the controlling shareholders act fraudulently or oppressively.[43] A court may appoint a receiver to determine a per share value and allow one faction to buy out the other. Discretionary provisional remedies, such as an injunction to prohibit certain conduct or a mandamus to compel the payment of dividends, are additional substitute means of redress.[44] The goal of these alternatives is to provide more inclusive and flexible grounds for relief.

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40. *Id.* Dissolution is often only a pretense to force the controlling faction to buy out the minority interest.

41. The courts are faced with an anomalous situation in which the remedy of forced dissolution may be equally "oppressive" to the majority shareholders. *See* Baker v. Commercial Body Builders, Inc., 260 Or. 614, 507 P.2d 387 (1973). Moreover, the termination of the enterprise may disfavor the minority in economic terms. "In many instances minority shareholders will not benefit from liquidation because the liquidation value of company assets may be small or the only available purchaser may be the very majority whose oppression drove the minority to seek redress." O'Neal, *supra* note 4, at 882.

42. *See* Roach v. Margulies, 42 N.J. Super. 243, 126 A.2d 45 (1956); Patton v. Nicholas, 154 Tex. 385, 279 S.W.2d 848 (1955); White v. Perkins, 213 Va. 129, 189 S.E.2d 315 (1972).

43. *See* N.J. STAT. ANN. § 14A:12-7(1)(c) (West Supp. 1982); VA. CODE § 13.1-94 (1978).

44. *See* the representative state statutes cited in note 23, *supra*. Most of these states have recognized a number of equitable remedies that depend on the facts in the case presented and the nature of the problems involved. These remedies may include dissolution under a suspensive condition, appointment of a receiver, court supervision of minority interests, injunctions to prohibit oppressive conduct, mandamus to compel dividend payments or capital distributions, or an award of damages to injured minority shareholders. *See* Fix v. Fix Material Co., 538 S.W.2d 351, 357 n. 3 (Mo. Ct. App. 1976).

> It has been suggested that legislation requiring compulsory arbitration of corporate disputes might be successful. . . . A forum would be offered for dealing with controversies before they reached that level of hostility which makes reconciliation impossible. At the same time, arbitration avoids the traditional judicial reluctance to intervene in the internal affairs of the corporation.

Afterman, *Statutory Protection for Oppressed Minority Shareholders: A Model for Reform*, 55 VA. L. REV. 1043, 1077 n. 148 (1969). Even with the increased availability and recognition of alternative remedies, the remedy of dissolution is still the most frequently used safeguard of minority rights. *See* Notzke v. Art Gallery, Inc., 84 Ill. App. 3d 294, 405 N.E.2d 839 (1980); Delaney v. Georgia-Pacific Corp., 278 Or. 305, 564 P.2d 277 (1977).

The *Streb* decision effectively closes the door on many minority grievances. *Streb* personifies the judicial hesitancy to encroach upon the time-honored doctrine of majority rule. The judiciary can and should grant relief to oppressed minority shareholders; moreover, the imposition of an equitable remedy does not have to await legislative prescription. Concededly, any judicial redirection necessitates an examination of the majority rights as well.[45] However, a viable solution requires a balancing of the competing equities involved, as the present scales are unbalanced.

Insolvent Corporations: Insider Preferential Transactions and Creditor Rights

The fiduciary nature of the officers' and directors' positions within a corporation imposes standards which govern any transaction between these insiders and the corporate entity.[46] Any unfair transaction made possible by a fiduciary relationship between the parties gives rise to liability with respect to the unjust enrichment of the fiduciary. Specifically, courts and commentators universally recognize that "[a] transaction by an officer or director with the corporation he serves which grants to him, as a bona fide but unsecured creditor of the corporation, preferred status over other unsecured creditors at a time when the corporation is known to be insolvent, is invalid."[47] Against this background of legal precepts, the case of *Missouri Meat Co. v. Richard*[48] was argued and resolved.

The plaintiffs in *Missouri Meat*, judgment creditors of a defunct corporation, sought reparation from the former owners of the insolvent corporation under sections 92 and 93 of the Louisiana Corporation Law.[49] The plaintiffs argued that the insiders violated their fiduciary duty to outside creditors when they granted a second mortgage on corporate property to cover antecedent debts owed by the corporation to the insiders.[50] The plaintiffs further alleged that this second security interest restricted buyers from bidding on the assets of the corporation at a subsequent foreclosure sale, causing the assets

45. "After all, the remedy of a forced dissolution of a corporation may be equally 'oppressive' to the majority stockholders." Baker v. Commercial Body Builders, Inc., 264 Or. 614, 630, 507 P.2d 387, 394 (1973).

46. *See* 15A W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 7412 (1967); W. KNEPPER, LIABILITY OF CORPORATE OFFICERS AND DIRECTORS § 2.13 (3d ed. 1978).

47. Missouri Meat Co. v. Richard, 407 So. 2d 17, 21 (La. App. 3d Cir. 1981), *writ granted*, 412 So. 2d 87 (La. 1982); *see* Abraham v. Lake Forest, Inc., 377 So. 2d 465 (La. App. 4th Cir. 1979), *writ denied*, 380 So. 2d 99 (La. 1980).

48. 407 So. 2d 17 (La. App. 3d. Cir. 1981), *writ granted*, 412 So. 2d 87 (La. 1982).

49. LA. R.S. 12:92 & 93 (Supp. 1968).

50. The validity of the debts that arose from advances made to the corporation was not at issue in *Missouri Meat*. 407 So. 2d at 20.

to be sold at values below their market price.[51] The third circuit concluded that the preferential transfer was invalid[52] but, nevertheless, decided that the plaintiffs could not recover because the owners received nothing of "value"[53] as required by sections 92 and 93.

The Louisiana statutes[54] and other state provisions[55] which address the problem of unlawful distributions can be traced to the New York Stock Corporation Law of 1890.[56] Under this law, fradulent[57] conveyances by officers and directors have been declared invalid since the turn of the century. The third circuit, however, was unable to redress the impropriety because the distribution was appraised as worthless. Conceivably, the court could have placed an objective value on the second mortgage.[58] The preferential security interest had some inherent value, notwithstanding the fact that the judicial sale returned only enough funds to cover the first mortgage on the property.[59]

As an alternative, the court in *Missouri Meat* could have concluded that the defunct corporation was merely the alter ego of its

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51. The facts of the case suggest impropriety. For example, the former officers-owners of the defendant corporation bought the corporation's only assets at the judicial sale. 407 So. 2d at 20.

52. *Id.* at 21.

53. *Id.* at 22.

54. LA. R.S. 12:92 & 93 (Supp. 1968).

55. *See, e.g.*, DEL. CODE ANN. tit. 8, § 174 (1974); MD. CORPS. & ASS'NS CODE ANN. § 2-315 (Supp. 1982); N.J. STAT. ANN. §14A:6-12(1) (West Supp. 1982); N.Y. BUS. CORP. LAW § 719 (McKinney 1977).

56. Section 48 (later moved to section 15) of the former Stock Corporation Law, 1890 N.Y. Laws 1075, was enacted in 1890 and was repealed with the adoption of the present New York Business Corporation Law, effective September 1, 1963. The purpose of section 48 was outlined in Munzinger v. United Press, 52 A.D. 338, 342, 65 N.Y.S. 194, 197 (1900).

> The evil to be obviated by that section was the giving of a preference by an insolvent corporation to its officers, directors, and stockholders who should become aware of the insolvency before that fact could become known to the general public. It was feared that in such a case they would be likely to devote the property of the corporation to the payment of their own debts, and thereby leave nothing for the other creditors who did not know of its condition.

Id. See also Anjopa Paper & Board Mfg. Co., 269 F. Supp. 241 (D.C.N.Y. 1967); Southern Indus., Inc. v. Jeremias, 66 A.D.2d 178, 411 N.Y.S.2d 945 (1978); Whalen v. Strong, 249 A.D. 792, 292 N.Y.S. 385, *aff'd*, 275 N.Y. 516, 11 N.E.2d 321 (1937).

57. *See* Tacoma Ass'n of Credit Men v. Lester, 72 Wash. 2d 453, 433 P.2d 901 (1967); *In re* IMI, Inc., 17 Bankr. 784 (E.D. Wis. 1982).

58. *See* Ficor, Inc. v. McHugh, 639 P.2d 385 (Colo. 1982). *Compare* COLO. REV. STAT. §7-5-114(3) (1973) *with* N.Y. BUS. CORP. LAW § 719 (McKinney 1963).

59. The jurisprudence generally recognizes that the amount realized at the forced sale of previously transferred property does not necessarily reflect the ordinary market value of such property. *See* DeWest Realty Corp. v. Internal Revenue Serv., 418 F. Supp. 1274, 1279 (S.D.N.Y. 1976); Continental Oil Co. v. Zaring, 563 P.2d 964 (Colo. Ct. App. 1977).

owners.[60] This conclusion would have disregarded the corporate entity, resulting in unlimited liability for the shareholders. The facts of the case do not readily justify a judicial piercing of the corporate veil,[61] but the remedies in sections 92 and 93 are not the exclusive means of relief for aggrieved creditors.[62]

Agency Powers in a Close Corporation

The distinct character of the close corporation extends beyond the area of shareholder interrelationships.[63] Contractual authority and agency power always create an area of uncertainty, especially when attached to the power and authority of the corporate officer.[64]

> This is a problem inherent in the ramifications of any organizational form. Such problems have been unavoidable and insoluable since the days when feudal lords objected to the practices of subinfeudation and mortmain. The truth of the matter is that society provides the forms of organization, but the law must struggle with their consequences.[65]

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60. For a very through discussion of this approach, see Tigrett v. Pointer, 580 S.W.2d 375 (Tex. Civ. App. 1978). *See also* DeWitt Truck Brokers, Inc. v. W. Ray Flemming Fruit Co., 540 F.2d 681, 685-87 (4th Cir. 1976).

61. See the discussion in the cases cited in note 60, *supra.*

62. *See* the sources cited in note 58, *supra*; *see also* Pepper v. Litton, 308 U.S. 295, 309-12 (1939); Duberstein v. Werner, 256 F. Supp. 515, 521 (E.D.N.Y. 1966). Under facts similar to *Missouri Meat*, one court imposed a judgment lien on the property in a third party purchaser's hands because of his knowledge of the creditor's claims, *i.e.*, the third party had notice and accepted the property subject thereto. Smith v. Mississippi Livestock Producers Ass'n, 188 So. 2d 758 (Miss. 1966). For a misapplication of the *Smith* rationale, see Wood v. Gulf States Capital Corp., 217 So. 2d 257, 271-72 (Miss. 1968).

63. See text at notes 12-45, *supra.*

64. Although the same broad principles of corporation and agency law determine the powers of officers in both close and publicly held corporations, the factual differences in the patterns of operation of the two kinds of corporations lead to wide disparities in the powers the courts actually recognize in corporate officers. In a close corporation, ownership and management normally coalesce; and the participants often conduct their enterprise internally much as if it were a partnership. The courts have seldom articulated a difference in the rules governing officers' powers in close and publicly held corporations; yet they appear in fact to have often cut through the technical legal form of close corporations to reach the results that would be reached if the enterprises were conducted as partnerships. In other words, the courts frequently, and perhaps usually, recognize in officers of a close corporation the same powers that are possessed by partners in a firm under the general rule of partnership law which makes each partner an agent of the firm for the purposes of its business and empowers each partner to bind the firm by acts apparently carried on to further the usual business of the partnership.

2 F. O'NEAL, *supra* note 21, at § 8.05.

65. Kempin, *The Corporate Officer and the Law of Agency*, 44 VA. L. REV. 1273, 1289 (1958).

The expression of corporate authority preeminently manifests itself in the board of directors. The collective action of the board epitomizes the business policy of the inanimate corporate entity.[66] The complex body of corporate law occasionally will be inadequate to resolve the peculiar problems intrinsic to the close corporation. The task of the judiciary is to avoid a draconian exegesis of the statutory law in favor of a more practical consideration of the differences presented by the corporate dichotomy.[67] The embodiment of agency problems confronted the third circuit in *Greenleaf Plantation, Inc. v. Kieffer*.[68] The plaintiff brought suit for specific performance of an option to purchase a tract of land from the defendants. The plaintiff was a small corporation formed by two shareholders to raise cattle and farm soybeans. Not surprisingly, the two shareholders were also the only officers of the corporation. The defendants alleged that the option agreement was invalid because the shareholder-officer who purported to exercise the option was without express authority to contract for the purchase of immovable property. The district court ruled in favor of the defendants, but the third circuit reversed the decision on appeal.

The court determined that the absence of a resolution by the board of directors was not fatal to the exercise of authority by the corporate president.[69] Two important facts probably influenced the decision of the court. First, the defendants did not complain of the president's lack of authority to exercise the prior lease to which the option was attached.[70] Second, the plaintiff already had incurred expenses toward completion of the sale when the defendant revealed his intention to abrogate the contractual obligation. These facts suggest that the

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66. *See* Coastal Pharmaceutical Co. v. Goldman, 213 Va. 831, 195 S.E.2d 848 (1973); Moore v. Aetna Cas. & Sur. Co., 155 Va. 556, 155 S.E. 707 (1930).

67. Corporations are creatures of statutory law. The same law which creates them provides procedures for the conduct of their affairs. Ordinarily, corporate conduct must conform to those procedures. But the total complex of corporate law acknowledges that all corporations are not alike and recognizes that strict statutory conformity, seldom practiced faithfully by the largest and most sophisticated corporations, is impractical if not impossible for others. For the law to close its eyes to the differences and attempt to compress all corporations into a neat little mold would be to forsake realism for legalism and often to sacrifice justice for standardization.

Coastal Pharmaceutical Co., 195 S.E.2d at 852. *See generally* American Fidelity Fire Ins. Co. v. Construcciones Werl, Inc., 407 F. Supp. 164 (D.V.I. 1975); Lettieri v. American Sav. Bank, 182 Conn. 1, 437 A.2d 822 (1980); Terminal Freezers, Inc. v. Roberts Frozen Foods, Inc., 41 Ill. App. 3d 981, 354 N.E.2d 904 (1976); Sturgeon v. State Bank of Fisk, 616 S.W.2d 578 (Mo. Ct. App. 1981).

68. 403 So. 2d 100 (La. App. 3d Cir.), *writ denied*, 409 So. 2d 675 (La. 1981).

69. *Id.* at 102. *See* text and authorities cited at notes 64-67, *supra*.

70. *See* American Fidelity Fire Ins. Co. v. Construcciones Werl, Inc., 407 F. Supp. 164 (D.V.I. 1975). *See generally* Trio Mobile Homes, Inc. v. West, 240 Ga. 474, 241 S.E.2d 234 (1978); B & C Enterprises v. Utter, 88 Nev. 433, 498 P.2d 1327 (1972).

equities of the case favored the plaintiff, but the law may have been against it.[71] The legal rationale of the court intimates that the law may have been contrary to the outcome. The court's reliance on the doctrines of estoppel, ratification, and apparent authority[72] suggests inconclusiveness, inasmuch as any single theory would have been sufficient to bind the defendant to the contract.

Resolving the consequences of corporate authority is a matter within the purview of state law. Without exception, each state has endeavored to unravel the problem of "officer authority"[73] within close corporations. Most jurisdictions have expanded traditional concepts by increasing a chief officer's executive authority to include the power to enter into contracts that are within the ordinary course of the business.[74] In *Sturgeon v. State Bank of Fisk*, the executive power was characterized as implied authority.

> It is now well settled that when in the usual course of the business of a corporation an officer has been allowed to manage its affairs, his authority to represent the corporation may be implied from the manner in which he has been permitted by the directors to transact its business.[75]

The *Greenleaf* court labored to find the exact legal theory under which

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71. *See* Marsh Inv. Corp. v. Langford, 490 F. Supp. 1320, 1327 (E.D. La. 1980), *aff'd per curiam*, 652 F.2d 583 (5th Cir. 1981); *Greenleaf*, 403 So. 2d at 105 (Domengeaux, J., dissenting); Lee Moving & Storage, Inc. v. Bourgeois, 343 So. 2d 1192 (La. App. 4th Cir. 1977).

72. 403 So. 2d at 104.

73. The problem centers around the extent of authority given an officer solely by virtue of his office. Clearly, an officer lacks the inherent power to execute a contract of unusual or extraordinary nature. Southwest Forest Indus., Inc. v. Sharfstein, 482 F.2d 915 (7th Cir. 1972); Goldenberg v. Bartell Broadcasting Corp., 47 Misc. 2d 105, 262 N.Y.S.2d 274 (Sup. Ct. 1965).

> At one end of the legal spectrum is the view that the office bestows no authority upon an officer. The more realistic and developing position is that the president has the residual authority to enter contracts binding upon the corporation that are within the ordinary course of its business. Determining what constitutes "ordinary" must be done on a case by case basis. It will depend upon, among other factors: the industry concerned, the custom and practice within the trade, past practice, the dollar amount of the transaction relative to the corporation's financial status, the presence or absence of an emergency, etc.

A. WOLFE & F. NAFFZIGER, LEGAL PERSPECTIVES OF AMERICAN BUSINESS ASSOCIATIONS 344 (1977).

74. *See* Royal Mfg. Co. v. Denard & Moore Const. Co., 137 Ga. App. 650, 224 S.E.2d 770 (1976); Hauptman v. Edwards, Inc., 170 Mont. 310, 553 P.2d 975 (1976); *cf.* Foster v. Blake Heights Corp., 530 P.2d 815 (Utah 1974) (secretary-treasurer had no authority to enter into a contract for the sale of corporate real estate).

75. Sturgeon v. State Bank of Fisk, 616 S.W.2d 578, 584 (Mo. Ct. App. 1981) (citations omitted); *see also* Terminal Freezers, Inc. v. Roberts Frozen Foods, Inc., 41 Ill. App. 3d 981, 354 N.E.2d 904 (1976).

it should bind the parties. Nevertheless, the message of *Greenleaf* is clear: third parties on notice of an agency relationship should determine for themselves the nature and extent of the agent's authority.[76] This position is consonant with the general agency law of Louisiana.[77] Third parties generally are considered as having entered into contractual transactions with corporate officers at their own risk. If the plaintiff had breached the contract in *Greenleaf*, then the court clearly would have found the presence of authority to exercise the option. Necessarily, the converse must also be true; a corporation cannot be required to assume the liabilities of such a contract and be denied its benefits. If implied or *de facto* authorization is sufficient to bind the corporation and its stockholders to obligations, then it is also sufficient to validate their rights.[78]

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76. *See* A. WOLFE & F. NAFFZIGER, *supra* note 73, at 344.

77. *See* Buckley v. Woodlawn Dev. Corp., 233 La. 662, 98 So. 2d 92 (1957); Graves v. Pelican Downs, Inc., 292 So. 2d 297 (La. App. 1st Cir. 1974); Carey Hodges Assoc. v. Continental Fidelity Corp., 264 So. 2d 734 (La. App. 1st Cir. 1972).

78. *See Coastal Pharmaceutical Co.*, 195 S.E.2d at 852.