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Agency, Partnerships & Corporations

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AGENCY

The agency cases reported in the period covered by this article, roughly June 1989 through June 1990, dealt with normal controversies about the disputed existence of an agency relationship,[1] the scope of alleged actual and apparent authority,[2] the adequacy of the disclosure of an agency relationship,[3] and the rights and duties of real estate brokers.[4] A second circuit decision also held that a negligent failure to

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1. London Livery, Ltd. v. Americana Travel, 544 So. 2d 1287 (La. App. 4th Cir. 1989) (no agency relationship where purported principal exercised no control over alleged agent, and had no authority or right to bind him); Willard E. Robertson Porsche-Audi, Inc. v. General Elec. Credit Auto Lease, Inc., 544 So. 2d 515 (La. App. 5th Cir.), writ denied, 550 So. 2d 631 (1989). In *Robertson Porsche-Audi*, an instruction from a lender to auto lease broker to enter into auto purchase contracts in the lender's name (to avoid double sales tax) was deemed to constitute express authorization to purchase cars in its name and on its behalf, making the broker the lender's agent for purposes of determining risk of loss arising from broker's failure to forward lender's payment to the auto dealer. This risk was nevertheless imposed on auto dealer in this case as a result of his participation in broker's scheme to obtain payment from lender prior to broker's payment to dealer.

2. Anderson Window & Patio Co. v. Dumas, 560 So. 2d 971 (La. App. 4th Cir. 1990) (enforcement of window supplier's subcontractor's privilege avoided under theory that installer of windows—an independent contractor who was paid in full for windows by homeowners—was either actually or apparently an agent of both the manufacturer and retailer of the windows for purposes of receiving payment for the windows); Hargroder v. Protective Life Ins. Co., 556 So. 2d 991 (La. App. 3d Cir.), writ denied, 559 So. 2d 1367 (1990) (school superintendent had no actual authority to reject alcoholism coverage in school board's health insurance plan; estoppel not raised at trial, and so not to be considered on appeal; apparent authority a form of estoppel).

3. Dash Bldg. Materials Center, Inc. v. Henning, 560 So. 2d 653 (La. App. 4th Cir. 1990) (shareholder's guarantee of one corporation's debt enforceable with respect to purchases made in name of another of his corporations, where seller was given no notice that identity of corporate purchaser had changed).

4. Bart v. Wysocki, 558 So. 2d 1326 (La. App. 4th Cir. 1990) (no duty to advise seller, a lawyer, that contract to sell his house lacked a condition of sale (i.e., seller's purchase of another house) that had been included in earlier contract); Naquin v. Robert, 559 So. 2d 18 (La. App. 4th Cir.), writ denied, 561 So. 2d 118 (1990) (duty to advise buyer of failure to obtain extension of term of purchase agreement from seller); Rodgers v. Johnson, 557 So. 2d 1136 (La. App. 2d Cir. 1990) (duty to advise buyer of known symptoms of foundation failure in house; liability in fraud or negligent misrepresentation

supervise amounted to a "physical tort" of the kind contemplated by the rule that a principal is not liable for the physical torts of a nonservant agent.[5]

One change in agency law occurred as a result of legislation that added "health care decisions" to the list of matters for which agency authority must be conferred expressly under Louisiana Civil Code article 2997.[6] Specifically included in the "health care decisions" for which express authorizations will now be required are decisions concerning surgery, nursing home residency, medication, and the incurring of medical expenses.

An "express" authorization need not necessarily be in writing—a patient might expressly, though orally, authorize an agent to make a health care decision on his behalf—but for planning purposes, the authorizations required by the amended Article 2997 should normally be secured in writing so that reliable evidence will be available in the event that a purported authorization is later challenged.

"Right to die" declarations are specifically *excluded* from the new requirement of express authority and continue to be governed by Louisiana Revised Statutes 40:1299.58.1-.58.10.[7] It is possible under these "right to die" provisions for certain relatives or representatives of a comatose patient to permit the discontinuation of life support for that patient, even though he has *not* previously given any such authority to these statutorily-designated decision-makers, provided, among other things, that the patient involved is certified by physicians either to be profoundly comatose, without any reasonable chance of recovery, or to be suffering from an irreversible and terminal condition.[8]

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for breach of this duty); Tammariello Properties, Inc. v. Medical Realty Co., Inc., 549 So. 2d 1259 (La. App. 3d Cir. 1989) (exclusive-right-to-sell contract given plain meaning interpretation that (i) entitled broker to commission under extension clause—where sale consummated between shareholders of listing corporation and entity whose representatives had been in contact with the listing corporation during listing period—but (ii) denied broker commission on appraised value of land "donated," along with improvements, which were sold for $1.8 million—commission due only on purchase price).

5. Daniels v. Dauphine, 557 So. 2d 1062 (La. App. 2d Cir.), writ denied, 561 So. 2d 100 (1990) (assuming that resident's failure to supervise lawn-mowing by children was negligent, and that resident was agent of landowner for purposes of keeping grass cut, nevertheless, landowner was not vicariously liable for this alleged negligence by resident because resident was not *servant* of land owner, and his negligence was of the physical kind contemplated by the rule in Rowell v. Carter Mobile Homes, Inc., 500 So. 2d 748 (La. 1987), i.e., that principals are not liable for the tortious physical conduct of their nonservant agents).

6. 1990 La. Acts No. 184, § 1.

7. Id.

8. La. R.S. 40:1299.58.2, .58.5 (Supp. 1990); 1990 La. Acts No. 749, § 1 (amending La. R.S. 40:1299.58.2(7) (Supp. 1990)).

PARTNERSHIPS

Partnerships vs. Unincorporated Associations

In *Ermert v. Hartford Ins. Co.*[9] the supreme court provided—for the first time in Louisiana—the beginnings of an explicit theoretical framework for the law governing nonprofit, unincorporated associations. Before *Ermert*, Louisiana law had dealt with this form of organization in a rather piecemeal fashion, resolving the particular disputes being posed, but without providing much guidance on the relationship between the law of unincorporated associations and that of other similar, though distinguishable, forms of human organization.

The narrow question posed in *Ermert* was whether the appellate court had erred in imposing vicarious liability on the members of an alleged "hunting club" for the damages caused by another member's negligent shooting of a guest at the club's hunting camp. The fourth circuit, reversing the trial court, had imposed solidary liability on grounds that the members of the group had failed to enforce adequate safety rules, and that the injury had occurred in an activity carried out for the benefit of the association and in the presence and with the tacit assent of all of those members being held liable.[10] The supreme court reversed the appellate court, ruling that no liability could be imposed on any of the hunters based on their membership in the purported association, for no such association had ever been formed. Finding no association, the court deferred any discussion of the vicarious liability that might be imposed on members of that kind of organization.

This case has a significance beyond the narrow issue actually decided because in its discussion of whether an association had been formed, the court chose to explain how such an association *might* be formed, and in so doing provided what amounted to a jurisprudential definition of an unincorporated association: "Under both civilian and common law theory, an unincorporated association is created in the same manner as a partnership, *by a contract between two or more persons to combine their efforts, resources, knowledge or activities for a purpose other than profit or commercial benefit.*"[11]

The court indicated that these association-creating contracts would, like other forms of contract, be governed by the Louisiana Civil Code

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9. 559 So. 2d 467 (La. 1990).

10. Ermert v. Hartford Ins. Co., 531 So. 2d 506, 510-12 (La. App. 4th Cir. 1988). Judgment for one of the defendants was affirmed on grounds that the plaintiff had not proven that he was a member of the club, and that he had neither been present nor tacitly approved of the activity that resulted in the injury. Id. at 512.

11. 559 So. 2d at 473 (emphasis added).

provisions pertaining to contracts generally and that, where appropriate, the more specialized principles of partnership law should be applied by analogy.[12]

In describing the way in which a nonprofit association might be formed, the court seemed deliberately to track the codal definition of partnership, which states that: "A partnership is a juridical person, distinct from its partners, created by a contract between two or more persons to combine their efforts or resources in determined proportions and to collaborate at mutual risk for their common profit or commercial benefit."[13]

By tracking the partnership language and by saying explicitly that partnership principles could be applied by analogy to nonprofit associations, the supreme court appears to be inviting a "compare and contrast" exercise for lower courts that find themselves faced with an issue of nonprofit association law. The court seems to be saying that partnership law is a good starting point for the analysis of an issue involving nonprofit associations, but that distinctions do exist between these two forms of organization that should preclude the automatic, wholesale application of partnership law to the nonprofit form of unincorporated association.

Ermert suggests that the supreme court has itself identified four such distinctions:

Nonprofit purpose: Unlike a partnership, which by definition is formed for purposes of profit or commercial benefit, a nonpartnership, unincorporated association is formed for purposes *other* than profit.[14]

Contributions: The court's listing of the types of contributions recognized in the formation of a nonprofit association reflects an effort to make the rule in nonprofit associations even broader than the seemingly all-encompassing "efforts or resources" phrase in the partnership definition. In addition to the "efforts or resources" acceptable in partnership formation, nonprofit associations may be formed through contributions of "knowledge or activities."[15]

The court also left out of its association description the "determined proportions" phrase found in the Louisiana Civil Code's definition of

12. The court also indicated that the principles underlying the recently-repealed corporations articles of the Civil Code should also be applied by analogy, 559 So. 2d at 473, but because these provisions dealt mainly with the issue of juridical personality (and on that issue actually seem to run contrary to the direction the court took in its analysis—opposing rather than favoring the private creation of juridical personalities—see former La. Civ. Code art. 446 (1870)), the effect of these former provisions is likely to be limited at best.

13. La. Civ. Code art. 2801.

14. Ermert v. Hartford Ins. Co., 559 So. 2d 467, 473 (La. 1990).

15. Id.

partnership. That was a good phrase to omit, for even in partnership law it appears to be nothing but a carry-over of an early translation error of a French phrase that had meant "placed in common."[16] As mistranslated, this phrase suggests a requirement not generally recognized either in civil or in common law, i.e., that partnerships may be formed only if the relative sizes of the partners' contributions are specified in some way.[17] Indeed, though it is often recited in the jurisprudence as part of the accepted definition of partnership,[18] this requirement has seldom been used to reject a claim to partnership status where that claim could not have been rejected on other grounds as well.[19]

Risk: In contrast to the partnership definition, the court did *not* include in its association-formation language any statement concerning the risk or liability to third parties incurred by a member of a nonprofit association. It deliberately put off the question of the nature of the liabilities that arise as a result of membership in an unincorporated association.[20]

Separate juridical personality: Although it spent more time discussing this issue than any other, the *Ermert* court never actually said that a

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16. See Historical Notes to former La. Civ. Code art. 2801 (1870).

17. See, e.g., Pothier on Partnership ¶ 1 (O. Tudor, trans. 1854) ("Partnership is a contract, by which two or more persons put, or oblige themselves to put, something in common, in order to make therefrom in common a lawful profit, of which they reciprocally bind themselves to render each other an account."); Unif. Partnership Act § 6, 6 U.L.A. 22 (1969) ("A partnership is an association of two or more persons to carry on as co-owners a business for profit."). Indeed, the very fact that the Civil Code would provide suppletive rules concerning the proportions in which partners were to share in the profits and losses of a partnership, La. Civ. Code arts. 2803, 2804, would suggest that the Code does not anticipate that the partners will always specify the proportions of their respective contributions.

18. Most Louisiana partnership formation cases recite some version of the test established in Darden v. Cox, 240 La. 310, 123 So. 2d 68 (1960). In its full, unabbreviated version, the *Darden* test does include the "determined proportions" language found in La. Civ. Code art. 2801. As a result, this requirement is often mentioned in the cases. For a more general discussion of the various tests of partnership formation in the Louisiana jurisprudence, see Morris, Developments in the Law, 1985-86, Business Associations, 46 La. L. Rev. 413 (1986).

19. Only two reported decisions actually seem to pay much attention to the "determined proportions" requirement, and both of them are "palimony" cases in which an unmarried person attempts to get marital property protection through the guise of partnership law. Glover v. Sowada, 457 So. 2d 101 (La. App. 5th Cir.), writ denied, 461 So. 2d 316 (1984); Foshee v. Simkim, 174 So. 2d 915 (La. App. 1st Cir. 1965). The courts in these two cases cite unbusiness-like informalities in the parties' accounting for profits and losses as evidence that the relationship in question was more personal than business in nature, or that concubinage rather than partnership was contemplated. But even in these two cases, it does not appear that the courts viewed the lack of "determined proportions" as critical to their decisions.

20. Ermert v. Hartford Ins. Co., 559 So. 2d 467, 475 (La. 1990).

nonprofit association ought to be treated for *all* purposes as having a juridical personality distinct from that of its members. The court acknowledged, seemingly with approval, that juridical personality had already been conferred on these associations for *certain* purposes, and that the usual trend in the law in this area was in the direction of increased recognition of this separate entity status. Nevertheless, the court omitted from its definition of association the "juridical personality" phrase found in partnership law, and it declined to declare that an association would be treated as a separate juridical person for all purposes.[21]

As with the question of risk, the court seems wise to have deferred consideration of the juridical personality issue beyond the extent necessary to render the decision in this case. Separate entity status might be granted for a variety of different purposes, ranging from efforts to simplify issues of civil procedure[22] to a decision to confer limited liability on members of the organization.[23] Given the great variety of different functional effects associated with a "separate entity" theory, courts are well-advised to limit their decisions in this area to the precise issue at hand.

Of course, the court did find it necessary in *Ermert* to discuss the juridical personality issue insofar as it affected the court's decision on the formation of the alleged association. The court held that an association could *not* be formed unless the purported members of the association had at least "conceive[d] of their creation as a being or thing separate from themselves."[24] In this particular case, the court ruled, no unincorporated association had been formed because the purported mem-

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21. Id. at 472-75.

22. See La. Code Civ. P. art. 689, comment (a) (unincorporated association granted procedural capacity even though, in substantive law, not considered a legal entity).

23. The limited liability of a corporate shareholder, for example, is based conceptually on the separate legal personality of the corporation (see, e.g., Glazer v. Commission on Ethics for Pub. Employees, 431 So. 2d 752 (La. 1983)), yet in partnership law, where the business association is also supposed to be a separate entity, La. Civ. Code art. 2801, the old nonentity theory of personal liability continues to control for most practical purposes, rendering partners personally liable as if they were, directly and personally, joint obligors on the partnership's debts. La. Civ. Code art. 2817; see Pothier on Partnership ¶ 96 (O. Tudor, trans. 1854) (The personal liability of commercial partners founded in part on policy of encouraging the extension of credit, and "is founded also upon the principles of our French law (differing in this respect from those of the Roman law in the law 4. ff. De Exerc. Act.), that partners in trade are considered to be agents and managers *for each other* of the business of the partnership." (emphasis added)). The only practical impact of the entity theory insofar as partner liability is concerned is to require joinder of the partnership in a suit to collect a partnership debt, La. Code Civ. P. art. 737, and to allow the partners to assert the practically useless right of discussion, La. Civ. Code art. 2817; La. Code Civ. P. arts. 5151-5156.

24. 559 So. 2d at 474.

bers of the association had not intended to form anything in the nature of a separate hunting club or other similar form of organization; several friends had simply gotten together and shared the expenses of operating a hunting camp together. Without this intention to form an association with a personality distinct from that of its members, the court said, "the parties do not create a fictitious person but instead simply incur obligations among themselves."[25]

It would not seem correct to interpret this opinion to say that private parties may themselves decide the legal question of whether their organization should be treated as having a separate legal personality. The separateness contemplated here is a separateness in fact—in the parties' perception and treatment of their organization—and not a separateness in terms of legal contemplation, for that is something over which private parties would normally be deemed not to have any control.[26]

Liability of Partners

The fourth circuit held in *Laporte, Sehrt, Romig & Hand, CPA's v. Gulf Island Operations*[27] that the parties to a partnership contract may modify the normal, "virile share" liability rule contained in Article 2817 of the Civil Code, and by the terms of their contract assume solidary liability for the debts of the partnership. That result was not at all surprising, but it does provide authority, directly on point, that may assist Louisiana practitioners in obtaining and defending a desired "partnership" tax classification for their clients' businesses.[28]

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25. Id.

26. See La. Civ. Code art. 24 ("A juridical person is an entity to which *the law* attributes personality. . . .") (emphasis added). Cf., Darden v. Cox, 240 La. 310, 320, 123 So. 2d 68, 72 (1960) (in discussing creation of partnership, another form of juridical person created by contract, court quoted with approval from earlier case, "If it be found that [the parties] have agreed upon all those matters which, in law, constitute a contract of partnership, it must be presumed that they intended that contract. If, on the other hand, some essential element to that contract is omitted, it is not a contract of partnership, no matter what it may be called.") (quoting Amacker v. Kent, 144 La. 545, 553, 80 So. 717, 720 (1919)).

27. 557 So. 2d 359 (La. App. 4th Cir.), writ denied, 561 So. 2d 120 (1990).

28. Louisiana is the only state in the country that does not impose personal liability directly on general partners for the entirety of their partnerships' debts; in Louisiana the liability is secondary and virile. See La. Civ. Code art. 2817. Not surprisingly, federal tax law follows the view of the other forty-nine states, and distinguishes partnerships from corporations in part on the basis of the lack of limited liability in a partnership. See generally Treas. Reg. §§ 301.7701-2, .7701-3 (1967); Rev. Proc. 89-12, 1989-1 C.B. 798; 1 A. Willis, J. Pennell & P. Postlewaite, Partnership Taxation §§ 34.01-.11 (4th ed. 1990). Louisiana's virile share rule therefore raises some question about the satisfaction of this element of the federal tax classification scheme. To eliminate that question, a tax adviser might sometimes wish to have a client explicitly *assume* solidary liability. See

Withdrawal—Valuation of Interest

The supreme court held in *Shopf v. Marina Del Ray Partnership*[29] that actual arms-length transactions were the best indication of the "value" required by Louisiana Civil Code article 2823 to be paid to a partner upon his withdrawal from the partnership. Finding evidence in the record of arms-length transactions at $3,000 to $3,553 per percentage point of partnership interest, the supreme court reversed the trial and appellate court conclusions, which had been based on unrebutted expert testimony, that the partnership interest involved was worthless.

The actual arms-length transactions, the court ruled, were the best indication of true value. Seeming to give the defendant and his appraiser the benefit of every doubt, the court observed that the appraiser had "[a]pparently . . . not [been] aware of these [market] transactions,"[30] and that the defendant's own valuation of the partnership on his personal financial statements and loan applications, rather generous figures ranging from $50,000 to $62,395 per point, also did not reflect true market value, but instead "the price an interested seller who has invested significant amounts of money in a speculative venture hopes to receive for his property."[31]

The court did adjust the market figure to reflect a 33 1/3% minority discount, despite the fact that initial offer made to the plaintiff of $3,552 per point had occurred when the defendant was already the majority partner. In support of its discount, the court cited only a reference book that indicated that discounts of that kind were normally applied due to the illiquidity of a minority interest. This portion of the opinion is subject to criticism on at least four grounds.

First, to the extent that the discount being imposed truly is an "illiquidity" discount, reflecting merely the difficulty of turning the investment involved into cash, the application of the discount ignores the very purpose of the mandatory buy-out rule: to provide a cash buyer where none would be available in the market. If a partner's interest really was going to be discounted to the price he would receive in a marketplace transaction, then the buy-out rule would do him no

Casey & Backstrom, The Louisiana Partnership and the Federal Income Tax—A Clashing of Codes, 44 La. L. Rev. 637 (1984). In that case, the adviser would certainly wish to be able to express the opinion to the I.R.S. that such a voluntary assumption of liability in the partnership contract would indeed be enforceable by third parties. The *Laporte* case, discussed in the text, provides authority that would support such an opinion.

29. 549 So. 2d 833 (La. 1989).

30. Id. at 839.

31. Id.

good; he could do just as well in the marketplace without incurring all the lawyers' fees and litigation expenses.[32]

Second, the withdrawal and buy-out mechanism was added to the Civil Code in 1980 as a means of simplifying the *procedure* associated with a partner's leaving the partnership. Under the Uniform Partnership Act (in effect in all states except Louisiana) and under earlier Louisiana law, a withdrawal of this kind would have allowed the withdrawing partner to demand a liquidation of the entire partnership, and a *proportionate* distribution of the value of partnership assets remaining after the payment of creditors' claims.[33] There is no indication in the Code or the Revision Comments that the drafters of the new provisions intended to change the *substantive* rights of partners,[34] and to subject withdrawing partners to the same deep discounts that minority shareholders in corporations face when, because they *lack* the sell-back rights that partners are supposed to have, they are forced to look to the marketplace for a liquidation of their interests.

Third, if the courts are going to discount values when partners "withdraw" from a partnership, but are going to require the Civil Code mandated proportionality of distributions in a "liquidation" of a partnership,[35] then they are going to encourage litigation over a largely unnecessary[36] new legal issue. Disgruntled minority partners will wish to

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32. See Morris, Developments in the Law, 1987-1988, Business Associations, 49 La. L. Rev. 277, 297-302 (1988). Of course, a seller of a partnership interest could only "share" his interest with a buyer, he could not actually get him admitted to the partnership without the unanimous consent of the other partners. La. Civ. Code arts. 2807, 2812. But to the extent that this fact would depress the "market" price for the partnership interest, an appropriate discount for nontransferability ought to be included in a court's valuation if market values are truly going to control.

33. Unif. Partnership Act §§ 29, 31, 37, 38, 40, 6 U.L.A. 364-469 (1969); 2 A. Bromberg & L. Ribstein, Partnership §§ 7.01, 7.09-.11 (1988) (U.P.A.); Former La. Civ. Code arts. 2876, 2890 (1870); Darden v. Cox, 240 La. 310, 123 So. 2d 68 (1960).

34. See comments to La. Civ. Code arts. 2818, 2819, 2823, 2824. In particular, La. Civ. Code art. 2824 comment (a) indicates that the elimination of the right of partition was intended only to protect the partnership from an insistence on in-kind, as opposed to cash, distributions. Nothing anywhere in the new articles, or in the comments to those articles, suggests that the *value* of the payment was to be reduced in some way. Indeed, a reduction in value would have affected the rights not only of partners, but also of the partners' creditors, for under the new articles, their right to seize partnership assets was replaced with the right to seize the debtor partner's interest in the partnership, and to force the partnership to pay its value. The clear implication of the Revision Comments is that the new provisions were to provide rights both to creditors and to partners that had substantially the same economic value, while also protecting the partnership from unnecessary partition actions.

35. La. Civ. Code art. 2833.

36. As indicated later, the distinction between withdrawal and liquidation may also be posed in a dispute over the identity of the person(s) to be entrusted with the responsibility

liquidate rather than withdraw, so that they will receive proportionate rather than disproportionate distributions, and so will have an incentive to allege the occurrence of some "terminating" event. The remaining majority partners, on the other hand, will effectively be able to expropriate value from the minority partners if they can characterize the event involved as a withdrawal or expulsion, and so will argue that no true "termination" has really occurred. The court will then be in a position of deciding whether to allow, or to prohibit, what amounts to an expropriation of value from minority investors based on some abstract consideration of the difference between "true" partnership termination, and mere "membership-cessation." A more absurd controversy is difficult to imagine. It could be avoided if the courts would simply declare that the same value is owed to the former partners whether their cessation of membership is due to a withdrawal or to a liquidation of the entire partnership. This in turn would require a rejection of so-called illiquidity discounts in the valuation of partnership interests in the context of partner withdrawals.

Finally, and perhaps most importantly, the 33 1/3% discount that the court imposed in this case really cannot be attributable solely to "illiquidity"; it is much more associated with the court's own willingness to protect the disproportionate share of earnings typically enjoyed by a majority owner of a business.

Strictly speaking, an "illiquidity" discount should refer to nothing more than the difficulty associated with turning a noncash investment into cash in the marketplace, regardless of its minority or nonminority status.[37] The marina being constructed by this partnership, for example, was an illiquid investment. To the extent that delays and costs would be incurred in turning the marina into cash in the market place, the value of the marina to its owners, if it were being sold, could be discounted to reflect its illiquidity. However, to the extent that the broader, marketplace discount applied to an investment included a reduction in value due to something *other* than these general liquidation costs, the discount is attributable to something other than mere illiquidity.

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of administering the transactions associated with a termination of membership by one or more partners. See infra text accompanying notes 44-50. But since judicial supervision of the liquidation or the withdrawal price is available, this is much less serious an issue than the basic question of whether the price to be paid, whether reached through private negotiation or litigation, is to reflect proportionate or disproportionate values. Once that basic issue is settled, there remains much less incentive to dispute the "true" meaning of partnership termination in La. Civ. Code art. 2826.

37. In connection with fixed-term investments, such as certificates of deposit, it may also be used to refer to the inability of the holder of the investment to obtain cash for his investment without a discount for the risk associated with the "locking in" of a particular interest rate over the term of the investment.

In this case, the discount seemed more a "minority" discount than a simple illiquidity discount. The minority discount is applied in connection with sales of business investments where the anticipated return on investment to the minority owner is lower than it would be, on a proportionate basis, if the returns available on the assets owned by the business actually were realized and distributed proportionately to the various owners of the business.

Assume that the marina in this case had a market value of one million dollars. It would have that value only because the market had estimated that the marina would be capable of generating a future income stream for its owners that had a present cash value, taking risk into account, equal to one million dollars. In theory, if the owners of this business really produced and shared in the income stream in proportion to their nominal percentage of ownership, it would matter very little whether an investor owned 25% or 75% of the business. A slight transaction-cost discount might be taken to reflect the multiple purchases that would be required to accumulate a given percentage of ownership through small, rather than large, block purchases. But subject to this relatively small discount, a 25% interest that really was expected by the market to provide its owner with 25% of an income stream having a present value of one million dollars would itself be worth 25% of the one million dollar figure, or $250,000.

The fact that the market discounts this figure as deeply as it does when a minority investment is involved is a reflection of the fact that the market anticipates that the minority investors in the business are *not* going to get their proportionate share of the business' earnings, and conversely, that the share of the majority investors is going to be disproportionately large. This is possible largely because the law gives the controlling persons of the business organization such enormous discretion in their management of the organization—usually without conferring any withdrawal rights on the investors—that they are able to expropriate a disproportionate share of the business' earnings.[38]

A mandatory "sell back" or "withdrawal" right in the hands of minority investors would serve as a powerful, market-based limitation on the ability of the controlling investors in a business to extract a disproportionately high share of the business' earnings, *but only to the extent that the price to be paid on withdrawal reflected a full, proportionate share of the overall value of the business.* If minority investors

38. See 1 F. O'Neal and R. Thompson, O'Neal's Oppression of Minority Shareholders §§ 1:03, 3:03 (2d. ed. 1985). The market also confers "control premiums" on majority and other controlling interests. This suggests strongly that the value represented in the discount of a minority interest does not simply disappear, but rather is transferred to the business' majority owners.

had a right to withdraw their proportionate share of the business' value at any time, then the controlling persons of the business would either produce and distribute reasonable earnings on the minority owners' investments, or they would lose control over these funds; they would not be capable of expropriating the lion's share of the business' value to themselves.[39] But if, on the other hand, the withdrawal payment to a minority investor was discounted, then to the precise extent of the discount, it would give the majority owner "playing room" in which to steal value without losing control over the funds. Acting rationally, the minority investor would leave his funds invested until the value of anticipated losses from ongoing managerial abuses was perceived by him to exceed the value of the "discount" that the majority investors would be capable of imposing on him when he withdrew.

That point is particularly important in partnership law, for unlike corporation law, partnership law is supposed to provide all partners with a withdrawal right[40] (unless they have agreed to a particular stated term for their investment[41]). The court in this case, therefore, had the chance to affirm that "value" in the case of partner-withdrawal meant "proportionate" value, the same thing it would have meant had the partnership been liquidated or if the property involved had been owned directly by the partners as owners in indivision. This would have helped protect minority partners from majority-partner expropriations of part of the minority owners' investments.

The court chose instead to diminish the legal protection of minority partners by imposing some purported "market" discount against the very market price that the controlling partner had already offered to the minority investor. In effect, this decision will mean that $100 in the hands of a partner will be worth $100 to him only as long as he keeps it out of the partnership. As soon as he contributes it to the partnership, it will cost the majority partners only 67 cents on the dollar to take it from him.[42] That ought not be the law.

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39. Obviously, this type of withdrawal right might also be used by minority investors to extort concessions when a cash-out of a particular interest would create liquidity problems for the corporation or partnership. Partnership law deals with this issue by permitting contrary agreements, by prohibiting early withdrawals without cause from partnerships constituted for a term, and by requiring that withdrawals from other partnerships be made upon reasonable notice, in good faith, and at a time not unfavorable to the partnership. La. Civ. Code arts. 2821, 2822. Corporation law recognizes no withdrawal right (except for dissenters' rights in mergers and merger-like transactions) and so does not address questions about the ways in which the right might be exercised.

40. La. Civ. Code art. 2822.

41. La. Civ. Code art. 2821.

42. Partners have no formal power of expropriation (unless they can find grounds for expulsion, La. Civ. Code art. 2820), but they will be able in their management of the partnership, to steal value from the minority investor up to the point that he finds it cheaper to withdraw and take the court-imposed discount.

As usual, the marketplace will undoubtedly end up *reflecting* this new discounting requirement, but it will not be responsible for it. When courts look to markets and see minority discounts, they are engaged in a circular exercise: they see discounts because the market anticipates that the courts will not protect proportionate distributions, and the courts do not protect proportionate distributions because they take it as a well-known axiom that the market discounts a minority interest. It is the courts that are the real decision-makers in this circle, and it is the courts that ought to break this indefensible, self-reinforcing cycle.

Partnership Termination and Liquidation

The second circuit held in *Sharplin v. Talley*[43] that a partnership terminates by operation of law and without the need for any formal judgment of termination upon the occurrence of any one of the terminating events listed in Article 2826 of the Civil Code. The issue was raised in the context of a suit by one partner to compel the liquidation of a two-member partnership on grounds of a deadlock in the management of the partnership. The defendant wished to avoid the termination and liquidation of the partnership itself, and sought instead to have the dissatisfied partner withdraw and accept some sort of secured payment arrangement in exchange for his interest in the partnership. The defendant argued that an action to compel a liquidation of the partnership required an allegation of "termination," which the court understood to mean some formal declaration or judgment of termination, and could not be maintained in the absence of such an allegation. The court ruled that no such formal declaration or judgment of termination was necessary and that a terminating event could simply be "factually alleged as the cause of action to compel liquidation and dissolution."[44] It affirmed the trial court's overruling of the defendant's exception of no right and no cause of action.

In a more innovative portion of the opinion, the court ruled that a managerial deadlock may, under the circumstances presented in this case, constitute an event that will terminate a partnership under Article 2826 of the Civil Code. Managerial deadlocks are not mentioned in Article 2826, but the second circuit reasoned in *Sharplin* that an absolute deadlock in management (involving in this case even day-to-day decisions) effectively makes it impossible for a partnership to accomplish its objectives. Because "impossibility" *is* one of the terminating events listed in Article 2826, the court concluded that a deadlock of the kind presented in this case constituted, indirectly at least, a terminating event.[45]

43. 561 So. 2d 820 (La. App. 2d Cir. 1990).
44. Id. at 821.
45. Id.

A more obvious cause of termination in this case would have been a reduction in the partnership's membership to one person, resulting from the disgruntled partner's withdrawal. This is a cause of termination explicitly listed in Article 2826. The problem with that approach, however, was that Article 2828 would have permitted the other, nonwithdrawing, partner to continue the partnership without a liquidation, and that was not what one of the two 50% partners wanted.[46]

In effect, therefore, this court could have handled the deadlock it saw in one of two ways: it could have insisted that one of the two parties withdraw, leaving the other party behind to manage the business and to pay the withdrawing partner for his interest, or it could have characterized deadlock as a terminating event that justified a liquidation of the partnership under rules that would permit the appointment of a judicial liquidator. It chose the latter, and that seems the wiser choice.

The chief practical difference between the two approaches, withdrawal and liquidation, lies in the identity of the person in charge of the winding up of the partnership's affairs; otherwise, the two processes have much in common.

In both withdrawal and liquidation, the person in charge can effectively "liquidate" the business either by selling all or part of it as a going concern or by selling its assets, one-by-one, in some sort of "fire sale" or "final auction" arrangement.[47] It is also possible in both

46. Impossibility would also have permitted a continuation, but only with the express or tacit assent of the partners, La. Civ. Code art. 2827, and in this case, one of the two partners was not going to consent.

47. The Civil Code does not use the term "liquidation" in dealing with cases of partner withdrawal, but it does say that the withdrawing partner is entitled to be paid, in cash, the fair value of his interest. La. Civ. Code arts. 2823, 2824. Thus, for all practical purposes, a withdrawal results in a partial liquidation of the partnership in the sense that the withdrawing partner's equity in the partnership assets is purchased either through an in-kind distribution acceptable to him or through a payment of cash (as agreed or judicially determined) from funds acquired through some combination of (i) partnership asset sales, (ii) partnership borrowings, and/or (iii) funding from the remaining partners. In a full partnership liquidation, *every* partner is entitled, as among the partners, to a proportionate distribution of partnership assets remaining after the payment of all debts and capital contributions. The assets left to be distributed may or may not be in the form of cash, but through some mixture of cash and in-kind distributions, every partner is entitled to be paid his share of the remaining assets. Any cash required in the liquidation will come either from asset sales or from partner contributions made to even things out. And although formal "partnership" borrowing will no longer occur, particular partners may well negotiate the functional equivalent by forming a new partnership to acquire some or all of the old partnership's assets, or one or more of them may simply incur a personal debt in order to acquire certain of the partnership assets, and then pledge or mortgage those assets as security for the loan.

In one way or another, therefore, the two chief functional differences between a partner withdrawal and a partnership termination lie in the scale of the liquidation involved and cases for the ultimate purchaser of some or all of the partnership assets to be either an outsider or one of the partners themselves.[48]

In a "withdrawal" case, however, the person who would make all these decisions about the terms of the sale would be the litigant who happened to be treated as the nonwithdrawing partner;[49] he would essentially be able to buy all the assets of the partnership, for resale or for continued use, in exchange for whatever terms he could negotiate with the withdrawing partner, or failing settlement, for the cash price he could convince a court represented the fair value of the withdrawing partner's interest.

In a "liquidation," on the other hand, neither partner would have that kind of tactical advantage; each would have to deal at arms length with the liquidator, and each would have to outbid both outsiders and the other partner in attempting to secure ownership of the partnership assets for himself. As a result, the liquidation approach seems more likely than defendant's suggested "withdrawal" technique not only to allocate funds and assets values fairly as among the former partners, but also to maximize the total amount realized by these partners as a group. As recognized in *Sharplin*, liquidation is the better choice.

In another recent decision on the subject of partnership liquidation, the fourth circuit held in *Laporte, Sehrt, Romig & Hand, CPA's v. Gulf Island Operations*[50] that the duties and liabilities of persons appointed to act as liquidators of partnerships are the same as those that apply to liquidators of corporations. This is consistent with the Civil Code rule that, absent contrary agreement, partnerships are to be liquidated in the same manner and according to the same rules that govern the liquidation of corporations.[51] Applying its interpretation of these corporate rules, the court ruled that a partnership liquidator may be

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the identity of the person(s) in charge of selling and/or distributing the partnership assets. Where only two persons are partners, there is only *one* difference: the identity of the liquidator, the remaining "proprietor" in the case of "withdrawal," and a formal "liquidator" in the case of a liquidation.

48. The nonwithdrawing partners can always turn a withdrawal into a termination simply by joining in the withdrawal themselves. They then are capable of purchasing the business from the liquidator and of continuing the business as a new partnership or proprietorship. The purchasing partners then would own the business for a net cost equal to what they paid, less the amount of the purchase price distributed to them as withdrawing partners, i.e., the amount needed to purchase the *other*, noncontinuing partners' interests. When some of the partners choose *not* to participate in the withdrawal, they are simply deciding to purchase the partnership assets for the same net cost through a procedure not involving a formal liquidation.

49. The very act of distinguishing the withdrawing partner from the partner remaining behind could be most difficult, for *both* partners might very well claim to be the nonwithdrawing partner in order to take charge of the splitting-up of the business assets.

50. 557 So. 2d 359 (La. App. 4th Cir. 1990).

51. La. Civ. Code art. 2834.

held personally liable to a partnership creditor *for the full amount of a partnership debt* (and not merely for the return of wrongly distributed assets) where he violates his fiduciary duty by distributing partnership assets to partners without first making adequate arrangements for the payment of that creditor.[52] The court also held that the liquidator, as the party responsible for administering the partnership's payments of its debts, was the party to whom a demand letter for the payment of a debt ought to be sent.[53]

CORPORATIONS

Legislation

Noncompete Agreements

Last year's legislation, amending the statutory rules on noncompete agreements set forth as Louisiana Revised Statutes 23:921,[54] was amended in 1990[55] in an apparent attempt to validate noncompete agreements entered into by shareholders in transactions in which, technically speaking, it is a corporation (rather than the corporation's shareholders) that possesses the characteristic (e.g., is selling business goodwill, or is a partner in a partnership) that is required by the statute in order to make the noncompete agreement enforceable. That is a sensible kind of amendment, as it would do little good in connection with purchases of incorporated businesses to restrict competition only by the fictional corporate entity that was technically the owner of the business being sold. If it were not possible to restrict competition by shareholders of the company as well, then it would be virtually impossible to negotiate a noncompetition agreement that had any real value; the actual human beings with the business knowledge and contacts—the things that make the noncompetition agreement necessary in the first place—would still be able to compete with the purchasers of the business.

Unfortunately, the amending language seems to have been inserted in the wrong place in the statutory language. Strictly construed, the statute now says that any person, including a corporation or its individual shareholders, may enter into a noncompete agreement if, for example, that person is selling the goodwill of a business. Given the fact that both corporations and shareholders are typically considered persons, the new language adds little to the original legislation. It still does not take

52. 557 So. 2d at 365.
53. Id. at 366.
54. 1989 La. Acts No. 639, § 1.
55. 1990 La. Acts No. 201, § 1.

care of the problem of a corporation's selling *its* goodwill, and the purchaser's using that to justify a noncompete agreement with the corporation's *shareholders*, for the shareholders—though now declared to be persons—are still not persons who are selling goodwill.

Venue in Actions Against Registered Foreign Corporations

Section 1 of Act 487 of the 1990 session of the legislature amended Louisiana Code of Civil Procedure article 42(4) to provide that an action against a foreign corporation licensed to do business in this state is properly venued in the parish where its principal place of business is located *or* in the parish designated in its application for authority to do business in this state as its principal business establishment. Formerly, the "de facto" principal place of business was not an alternative; only the place named in the application for authority to do business was proper.

Guarantees of Affiliate Company Debts

Act 848 amended Louisiana Revised Statutes 12:41(C) to state—as a remedial matter[56]—that a guarantee by one corporation of another corporation's debt is deemed to be "necessary or proper" to accomplish the corporate purpose of the corporation making the guarantee, provided that the company whose debt is being guaranteed is a 100% parent, subsidiary or sister-company of the guarantor.

This amendment is significant chiefly as it affects guarantees of parent and sister-company debts. Since the enactment of statutes such as Louisiana Revised Statutes 12:41B(6), there has been no doubt that business corporations possess the general power to enter into contracts of guarantee. Moreover, there has seemed to be little basis for objecting to a parent company's guarantee of a wholly-owned subsidiary's debts; borrowing money through a subsidiary is simply one means by which the parent corporation could acquire funds for the operation of the business that it owned, indirectly, through the subsidiary. In the case of "upstream"[57] or "lateral"[58] guarantees, however, the issues were quite different, for the effect a subsidiary's guarantee of a parent or sister corporation's debts was to subject its assets to claims from which it would receive no direct benefits: if the transaction turned out badly, the guarantor would lose money, while if it was profitable, the guarantor

56. 1990 La. Acts No. 848, § 2.

57. A guarantee of an obligation owed by a shareholder, whether that shareholder is an individual or another corporation.

58. A guarantee of an obligation owed by a corporation owned at least in part by the controlling person (whether an individual or a corporation) of the guarantor corporation.

would gain nothing beyond the intangible benefits of seeing an affiliated company make a profit.

Obviously, these arrangements occurred only where the shareholders of the benefitting corporation also controlled the guarantor, and as to those shareholders, little problem was seen in enforcing the arrangement to which they had agreed.[59] If the guarantor corporation also had nonconsenting minority shareholders or creditors, however, the effect of this type of arrangement was to allow the controlling shareholder to give *his* creditors a claim to the assets of the guarantor that would be equal to or senior in priority of payment to the claims of the shareholders and creditors of the company that was supposed to own those assets. In effect, the controlling shareholder would be stealing asset values from the guarantor's nonconsenting minority shareholders and creditors.

In that type of case, courts in other states sometimes refused to enforce the guarantee involved on an "ultra vires," i.e, a "no corporate power," theory. That theory had held that, no matter how broad a corporation's powers were said to be (including in most states the power to guarantee the debts of others), those powers could be exercised only in furtherance of the corporation's purpose of making a profit for itself. Because uncompensated upstream and lateral guarantees were made strictly for the purpose of producing profits in which the guarantor had no interest, either direct or indirect, such guarantees were considered under this theory to be outside a corporation's lawful powers.[60] The new legislation, by stating that such guarantees *are* appropriately connected to a corporation's purpose, pointedly rejects this theory, at least where the interests of minority shareholders are not at stake.

The interests of creditors are seemingly ignored by the new legislation, for the application of the new rule is conditioned only on the absence of minority shareholders and not on the absence or consent of creditors. The new provision does *not* leave creditors entirely unprotected, though, it simply eliminates ultra vires as one of the available theories of relief. Where an upstream or lateral guarantee causes or increases the insolvency of the guarantor, or gives the guaranteed corporation's creditors an unfair security interest or unlawfully high priority of pay-

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59. See, e.g., First Jewelers, Inc. v. Rosen, 119 Ga. App. 355, 166 S.E.2d 919 (1969); Bulger v. Colonial House of Flushing, Inc., 281 A.D. 847, 119 N.Y.S.2d 233 (1953); Goodman v. Ladd Estate Co., 246 Or. 621, 427 P.2d 102 (1967); Haynie v. Milan Exch., Inc., 62 Tenn. App. 36, 458 S.W.2d 23 (1970).

60. See, e.g., Industrial Scavenger Serv., Inc. v. Speedway State Bank, 136 Ind. App. 405, 202 N.E.2d 289 (1964); Werger v. Haines Corp., 277 A.D. 1108, 101 N.Y.S.2d 361 (1950), aff'd, 302 N.Y. 930, 100 N.E.2d 189 (1951); Goodman v. Ladd Estate Co., 246 Or. 621, 427 P.2d 102 (1967); Inter-Continental Corp. v. Moody, 411 S.W.2d 578 (Tex. Civ. App. 1966); Annotation, Validity of Obligation Given by Corporation Incident to Purchase of Entire Stock by Sole Shareholder, 71 A.L.R.3d 639 (1976).

ment, then more traditional theories of creditor-protection law would still be available to block or restrict the enforcement of the guarantee.[61] Given these types of protections, designed specifically to protect the interests of creditors without unduly interfering with the owners' operation of the business, it is difficult to see why the ultra vires defense ought to be available as well.

The new legislation leaves open the question of the availability of an ultra vires theory to a nonconsenting minority shareholder. Moreover, despite the efforts of the drafters to make the language seem nonexclusive,[62] the fact that the new language applies *only* if the corporation has no minority shareholders suggests that some different rule might apply where minority shareholders were indeed present.

But even where nonconsenting minority shareholders are involved, the problems posed by upstream and lateral guarantees seem poorly-suited to an ultra vires analysis. The real problem with these guarantees is not that they are completely beyond the power of a corporation to issue and to perform,[63] but rather that one of the persons who is in control of the *exercise* of the corporation's power to enter into such contracts has caused the corporation to enter into the guarantee for reasons that disproportionately favor his own interests and disproportionately hurt the interests of minority investors.

This is plain old self-dealing. It is not a strange or novel problem for corporation law. Whenever the majority shareholder causes the corporation to pay him more than his contributions of time or property are worth, whether the transaction at stake involves an extravagant salary or an upstream guarantee, the problem is essentially the same: the majority shareholder is using his managerial power to steal part of the value of the corporation from the minority shareholders.

The only thing that makes the guarantee problem more difficult than more typical forms of self-dealing is that the majority shareholder's theft of value in the guarantee type of case depends on a third party lender's willingness to advance money based on the guarantee. In more

61. See, e.g., 11 U.S.C. §§ 510(c), 547, 548 (1988) (bankruptcy: equitable subordination, unlawful preferences and fraudulent transfers); La. Civ. Code arts. 2036-2043 (revocatory actions); Amp Serv. Corp. v. Richard, 419 So. 2d 911, 915-16 (La. 1982) (unlawful preferences under former La. Civ. Code art. 1983 (1870)); but see La. Civ. Code art. 2036, comment (g) (current revocatory action articles leave unlawful preferences to federal bankruptcy law)).

62. The introductory clause of new La. R.S. 12:41(C) provides that it is not to be construed to "limit[] the grant of power contained in Paragraph (6) of Subsection (B) of this Section to corporations to make contracts of guarantee or suretyship." 1990 La. Acts No. 848, § 1 (enacting La. R.S. 12:41(C)).

63. As a distinct juridical person, the corporation should either have—or lack—the power to issue these guarantees, one way or the other. Its power should not depend on whether it happens to have one or several shareholders.

common forms of self-dealing, the majority shareholder gets the money directly from the corporation itself through excessive salaries or lopsided bargains in purchase or sales transactions with the corporation. Thus, in the case of upstream guarantees the interests of these third parties would need to be taken into account.[64]

But there is still no reason to prefer an ultra vires analysis in these types of cases over the more straightforward thinking offered by traditional fiduciary duty doctrine. Ultra vires doctrine was designed to deal with *corporate* abuses of power that might hurt *society*,[65] not abuses of control power *within* the corporation that might hurt particular shareholders. Unlike ultra vires theory, therefore, fiduciary duty law can deal with the real issues posed without resorting to some on-again, off-again corporate power that creates unnecessary questions about the general enforceability of corporate guarantees.

Share Exchanges

As a result of Act 849,[66] Louisiana corporations are now empowered to engage in so-called "share exchanges," merger-like transactions that result in the acquired ("target") corporation becoming a subsidiary of the acquiror rather than a merged part of the acquiring corporation itself. Before this change in the law, transactions of this kind would have been carried out as "triangular mergers"—usually "*reverse* triangular mergers"—in which the acquiring corporation would have arranged a merger between the target company and a newly-established subsidiary of the acquiror.[67] Patterned after similar provisions in the Revised Model Business Corporation Act,[68] the new legislation allows

64. Despite the need for document-based commercial certainty, a court might well refuse to enforce an upstream guarantee in a transaction in which the lender knew, or is treated as having violated a duty to know, about the self-dealing effects of the transaction.

65. See Liggett Co. v. Lee, 288 U.S. 517, 548-57, 53 S. Ct. 481, 490-93 (1933) (Brandeis, J., dissenting).

66. 1990 La. Acts No. 849, § 31.

67. The subsidiary would have been capitalized with whatever property (e.g., shares of stock, debt instruments, cash, etc.) that the acquiror intended to exchange for the shares of the target company, and the plan of merger between the subsidiary and the target would provide for the distribution of these items of property in exchange for the relinquishment by the former shareholders of their interests in the target company to be merged. In most cases, the transaction was a "reverse triangular" merger, in which the subsidiary was actually merged into the *target* company, rather than the other way around. The "reverse" merger allowed the prospective parent to acquire the target without interrupting its corporate identity in any way; the very same corporation that had owned the target's assets before the merger would continue to own those assets after the merger. Only the identity of the owner of the corporation itself would have changed.

68. See Revised Model Business Corp. Act §§ 11.02-06 (1984).

the triangular merger transaction to be carried more simply, without the shell subsidiary, through a direct exchange of shares.[69]

However, the legislation has another, more subtle effect that may or may not have been intended. The new share exchange statute does for stock transactions what the "sale of assets" provisions[70] had already done for asset deals: it allows the circumvention of statutory dissenters' rights through a nominal role-reversal between the parties to the transaction.

In a triangular merger transaction, prior law would generally have required the approval of the shareholders of each corporate party to the merger, and would have conferred on those shareholders the right to dissent from the transaction and to be paid the fair value of their shares in cash.[71] Under the new legislation, voting and dissenters' rights are triggered in a share exchange strictly for the shareholders of the corporation being acquired; the acquiring corporation's shareholders have no such rights.[72]

This might seem to be a sensible rule at first, for if structured in the usual way, the share exchange may be seen as imposing a fundamental change in investment only on the shareholders of the acquired corporation. As to the acquiror, this type of transaction may be seen merely as one method for purchasing assets for the business, a matter generally left to the discretion of the corporation's management, without any voting or dissenters' rights for shareholders.

The problem with this type of analysis is that it ignores the ability that corporate management has to structure the transaction in an unusual way—to reverse the identity of the acquiring and acquired companies—so that the company that is nominally being acquired ends up controlling the nominal acquiror. Such techniques are well-known in connection with assets sales, where it is a simple matter to have a small company "buy" a much bigger company so as to give control over the small company (the nominal purchaser) to the larger, "selling" corporation.[73]

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69. 1990 La. Acts No. 849, § 1 (amending La. R.S. 12:111(A) (1969) and enacting La. R.S. 12:116).

70. See La. R.S. 12:121, :131(A) (1969 and Supp. 1990).

71. La. R.S. 12:131. The general right to vote and to assert dissenters' rights is subject to several exceptions, including those for so-called "short form," La. R.S. 12:112(G) (Supp. 1990) (no vote but dissenters' rights), and "small scale" mergers, La. R.S. 12:112(E) (Supp. 1990), and to a general limitation that dissenters' rights may not be asserted in transactions that receive approval from at least 80% of the total voting power of the corporation, La. R.S. 12:131(A) (1969). See Morris, supra note 32, at 289-92.

72. 1990 La. Acts No. 849, § 1 (enacting La. R.S. 12:116(K)).

73. When a smaller, "purchasing" company issues stock to a much larger "selling" corporation in proportion to the relative values of the two companies' assets, the "selling" corporation ends up the majority shareholder of the company that is nominally purchasing

The shareholders of the larger company normally don't care which corporate charter they use—the "purchaser's" or the "seller's"—as long as they end up in control of a company that owns the combined assets of the two companies involved. If they wish to avoid shareholder voting and dissenters' rights, therefore, a role reversal lets them do so.

It may still seem that the shareholders of *one* of the two companies must always be allowed to vote, so that the role reversal succeeds only as a means of letting the shareholders of the larger, nominally "acquired" company vote rather than those of the smaller, nominal "acquiror." That is not the case. All that management has to do to avoid *all* genuine shareholder voting is to engage in a "reverse triangular share exchange" in which the "acquired" company is actually a wholly owned subsidiary of the larger of the two principal companies involved. In this transaction, the subsidiary's shareholders do indeed get to vote, but since all of those shares are owned by the parent company, and are controlled in their voting by the parent company's management, no real voting by outside investors ever needs to occur. The managers of the two companies involved can cut their own deal, without the shareholders of either company ever being given the opportunity to vote or to assert dissenters' rights.

The role reversal technique, and other forms of creative, merger-like transactions, have not gone unchallenged. Some courts in other states have utilized a "de facto merger" doctrine to confer voting and dissenters' rights where techniques of this kind are employed.[74] But Delaware, the leading corporation law jurisdiction, has adopted an "equal dignity" theory that allows the use of one corporate combination mechanism, for example a role-reversed asset sale, as a means of circumventing the seemingly mandatory rights provided in connection with another such mechanism, such as a merger.[75] Other courts have either followed the Delaware theory[76] or found the de facto merger theory inapplicable under the particular facts presented.[77] A leading corporate commentator

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the assets. The "purchaser" produces its own parent company by issuing more stock to a larger "seller" than it formerly had outstanding. If the controlling shareholders of the new parent wish to own the controlling stock directly, they need only liquidate the "selling" company, and transfer the stock directly to themselves.

74. E.g., Pratt v. Ballman-Cummings Furniture Co., 261 Ark. 396, 549 S.W.2d 270 (1977); Perl v. IU Int'l Corp., 61 Haw. 622, 607 P.2d 1036 (1980); Applestein v. United Board & Carton Corp., 60 N.J. Super. 333, 159 A.2d 146, aff'd, 33 N.J. 72, 161 A.2d 474 (1960); Farris v. Glen Alden Corp., 393 Pa. 427, 143 A.2d 25 (1958). Cf., Morley Bros. v. Clark, 139 Mich. App. 193, 361 N.W.2d 763 (1984) (declining to use "de facto" label, but providing similar relief).

75. Hariton v. Arco Elecs., Inc., 41 Del. Ch. 74, 188 A.2d 123 (1963).

76. Bove v. Community Hotel Corp. of Newport, 105 R.I. 36, 249 A.2d 89 (1969).

77. E.g., Pomierski v. W.R. Grace & Co., 282 F. Supp. 385 (N.D. Ill. 1967); Alaska Plastics, Inc. v. Coppock, 621 P.2d 270 (Alaska 1980); Cummings v. United Artists Theatre Circuit, Inc., 237 Md. 1, 204 A.2d 795 (1964).

has questioned whether the provision of dissenters' rights in *any* type of corporate combination makes sense,[78] though another has defended these rights through an economic analysis of investment expectations and the opportunity for "final period" managerial self-dealing, i.e., selling out shareholders in a transaction that by its very nature will keep managers from being held accountable in future dealings with investors.[79]

Louisiana jurisprudence does not address this precise problem, but a 1983 supreme court decision, *Levy v. Billeaud*,[80] does utilize fiduciary duty theory to confer what amount to dissenters' rights in a transaction in which the corporate statute itself seemed plainly to deny such rights.[81] Because the analysis in *Levy* is vague—it opposes "oppression" of minority shareholders but fails to show how the transaction involved actually was oppressive[82]—it is difficult to say whether a role-reversed share exchange would be considered "oppressive" enough to warrant a *Levy*-like judicial intervention in that sort of case. But the argument would actually seem stronger in a role-reversal case than it did in *Levy* that the legislature really did not intend to authorize that kind of avoidance of dissenters' rights.

In *Levy*, nothing was done to structure the transaction so that shareholders would be denied their right to vote. Indeed, the shareholders in *Levy* did vote, and they would have been entitled to assert dissenters' rights had it not been for the fact that the corporation statute explicitly denied such rights where the transaction in question was "approved by at least 80% of the total voting power." The transaction in *Levy* received 95% approval.

If the supreme court was willing to grant dissenters' rights in *Levy*, where the statute affirmatively denied them, then it ought to be even more willing to grant them in role-reversed share exchanges, where it is at least arguable that the parties have utilized *unintentional* loopholes in the statutory scheme.[83]

78. Manning, The Shareholder's Appraisal Remedy: An Essay for Frank Coker, 72 Yale L.J. 223 (1962).

79. R. Gilson, The Law & Finance of Corporate Acquisitions 573-80 (1986).

80. 443 So. 2d 539 (La. 1983).

81. Id. at 545-46 (Blanche, J., dissenting).

82. As noted by Justice Blanche in his dissenting opinion, the "oppression" claimed in *Levy* was the same oppression shared by all minority shareholders: they may disagree with business decisions by the managers of the company, and wish to withdraw by selling their stock back to the corporation, yet the law gives them no such right. It is possible that the *Levy* court was moved by the change from a corporate form of business to a limited partnership, but there is nothing in the opinion that suggests how this might have injured the shareholder's interests, any more than a normal corporate merger or an amendment of the corporate articles would have.

83. It may be that the *Levy* court, with good reason, simply disagreed with the legislature about the wisdom of the 80% exception. None of the model corporation statutes

Merger and Amendment Voting

Act 849 did one other thing to the corporate statute that seems rather odd. It changed the voting levels required for various matters on which shareholder approval have traditionally been required.[84] The changes seem designed to clarify the voting levels required, but they are likely to have the very opposite effect.

Formerly, the various provisions involved[85] had specified some minimum figure required to obtain the necessary shareholder approval (usually two-thirds of voting power present), but had permitted the articles of incorporation to require any larger or smaller vote, provided that the smaller vote could not be less than a majority of voting power present. In an apparent attempt to make it clear that the *larger* vote could be some specified percentage of "total voting power," rather than merely a higher percentage of the normal "voting power present," Act 849 reworded the statutory language to declare that the required approval could be obtained "by such larger or smaller vote (not less than a majority) of the voting power present or of the total voting power as the articles may require."[86]

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has any such provision, and the rationale for the provision in Louisiana is unclear. Presumably, though, the exception is based on some notion that a transaction approved by 80% of the shareholders could not possibly be a transaction about which a minority shareholder could have any legitimate complaint. The major weakness in that theory is that it assumes that all shareholders are going to be treated equally in the transaction. In fact, plans of merger often treat shareholders in very different ways and are commonly used as a means of "squeezing out" minority investors. In modern practice, therefore, dissenters' rights are needed not so much to protect shareholders who are having a good faith disagreement about the wisdom of a particular transaction, but to stop an expropriation of the minority shareholders' stock at too low a price. Under these circumstances, the 80% exception amounts to a rule that 20% of the stock of the corporation may indeed be expropriated without triggering any rights on the part of the affected parties to obtain either a judicial valuation or a cash payment for their stock. See Morris, supra note 32, at 297-302.

If the explanation of *Levy* is a substantive disagreement about the 80% exception, however, the role-reversal technique would still seem subject to judicial attack, for in that case, the parties would simply be carrying out through clever planning what the legislature tried to do more openly through its 80% exception: to deny dissenters' rights in situations in which the general principles underlying the conferral of these rights would suggest that they ought to be available.

84. 1990 La. Acts No. 849, § 1. The act amended the voting requirements under La. R.S. 12:31(B) (1969), for amendments of the articles of incorporation; La. R.S. 12:31(C) (1969), for class-voting on amendments; La. R.S. 12:112(C) (Supp. 1990), on mergers and consolidations; La. R.S. 12:121 (1969 and Supp. 1990), for sales of substantially all assets; and La. R.S. 12:142 (1969 and Supp. 1990), for voluntary liquidations. It also added La. R.S. 12:116, on share exchanges, which utilized the same type of voting-level language.

85. La. R.S. 12:31(B)-(C), :112(C), :121, :142 (1969 and Supp. 1990).

86. 1990 La. Acts No. 849, § 1 (amending La. R.S. 12:31 (Supp. 1990)).

It is no longer clear, as it once was, whether the "majority" vote now referred to in the parenthetical phrase is a majority of voting power present or a majority of total voting power. The simple addition of a few clarifying words to the parenthetical phrases would straighten out the problem, but in the meantime, one can only hope that courts will not interpret the change in language to have increased the minimum acceptable vote.

On the positive side, Act 849 did make it clear that a "supermajority" shareholder voting provision in a corporation's articles, i.e, a provision requiring a higher-than-normal shareholder vote for a given act or transaction, may not itself be repealed or modified without at least the same higher-than-normal vote (unless the articles expressly provide to the contrary).[87]

Taxpayer I.D. Numbers Required

Act 745 amended the corporation and partnership statutes to require the inclusion of the business entity's federal taxpayer identification number in corporate articles of incorporation and annual reports, and in contracts of partnership filed for registry with the secretary of state.[88]

Fortunately, except for filings of registry statements by foreign partnerships, the new legislation provides that a failure to include the nominally "required" number does not invalidate the document involved, nor provide a basis on which the secretary of state may refuse to file it. It seems likely under these circumstances that the new requirement will be ignored by practitioners in connection with initial filings for corporations and partnerships that do not yet have a taxpayer identification number. Indeed, that seems to be what the new legislation is inviting.

From a technical standpoint, this is rather strange legislation. Few would quarrel with the basic objective of providing the identification number at some point, in an annual report or supplemental filing, for example, for the number does provide a convenient means of organizing and retrieving information for the businesses involved. But it is difficult to imagine, first, why the legislature would attempt to obtain this number in documents that are almost always filed before the number is obtained, and second, why the legislature would first "require" the number and then, by eliminating sanctions, invite practitioners to ignore the very requirement that it had just decided to impose. It would seem far simpler just to request the number "if available" at the time of the initial filing, and to require it in the first annual report or, for partnerships, in some

87. Id. (enacting La. R.S. 12:31(E)).
88. 1990 La. Acts No. 745, § 1.

supplemental report to be filed later. Indeed, if the number really is designed to organize corporate and partnership filings, it would seem sensible to require the inclusion of the number in *every* filed document *except* the initial articles of incorporation (or contract of partnership as no number has yet been obtained).

Bank Records—Shareholder Inspection

The legislature amended Louisiana Revised Statutes 6:279(A) to add a requirement that the minimum 2% stock ownership required to trigger the right to inspect the bank's corporate records (financial records are covered by a different subsection) must be held for a minimum of six months.[89] This is the same period required by the business corporation statute.[90]

Anti-Takeover Amendment

Act 613 amended Louisiana's so-called "Control Share Acquisition Statute" to provide a definition for the term "substantial assets" and to state rules for determining the location of the assets for purposes of this anti-takeover legislation.[91] These issues are important because the takeover protections of the Control Share Acquisition Statute may be claimed by a company only if, among other things, it owns "substantial assets" in Louisiana, or has sufficient numbers of Louisiana-resident shareholders.[92] The new definition provides that assets are "substantial" when they are worth at least five million dollars. The new language also permits a company's own board of directors, acting in good faith, to make the determination of the value of the company's assets, except to the extent that the assets consist of cash or securities that are either traded on an established securities market or quoted on NASDAQ.[93]

89. 1990 La. Acts No. 226, § 1.

90. La. R.S. 12:103(D)(1)(a) (Supp. 1990). The minimum percentage of ownership in the corporate statute is higher, however, 5% rather than 2%.

91. 1990 La. Acts No. 613, § 1. Rules for valuation are discussed in the text. The location rules provide that (a) corporeal property is deemed located where it is physically located, (b) incorporeal property represented by a written instrument is located where the instrument is located, and (c) incorporeal property not represented by a written instrument is located where the "commercial domicile" of the corporation is located.

92. La. R.S. 12:135, :136 (Supp. 1990). For a discussion of Louisiana's various anti-takeover statutes, see Morris, supra note 18, at 420-30; Morris, supra note 32, at 280-96.

93. 1990 La. Acts No. 613, § 1. The "good faith valuation" standard, like most other aspects of anti-takeover legislation, gives a tremendous advantage to the incumbent management of a target corporation in determining whether it wishes for the statute to apply.

No Filing Fees for Churches

Act 22 amended Louisiana Revised Statutes 12:205.1, concerning the filing of annual reports by nonprofit corporations, to exempt churches from the payment of the normal $5.00 filing fee.[94]

Cases

Stock Transactions

The third circuit held in *Miller v. Lake Arthur Reclamation Co.*[95] that the knowledge of a purchaser of stock about a transfer restriction purportedly applicable to that stock, but not noted on the stock certificate, is to be determined as of the time the contract of sale is completed between the purchaser and the seller, and not at the time that the nonlegended stock certificate is tendered to the issuing corporation for record transfer. The timing of the purchaser's knowledge about such restrictions is important because, if not noted on the stock certificate, those restrictions are enforceable against him only if he had actual knowledge of them.[96] In this case, the purchaser was unaware of the restriction at the time that he completed the contract of sale as between himself and the seller, but was told about the restriction before he tendered the certificate for transfer. If tender was the critical time, then the restriction was enforceable against the purchaser, while if completion of the contract was controlling, it was not. The court held that the time of contract formation was controlling and so refused to enforce the restriction.[97]

This was unquestionably the better result; the use of the stock certificate as a negotiable certificate of title would have been seriously undermined had the court enforced transfer restrictions discovered by the purchaser *after* he had already entered a contract of sale.

Two other recent decisions were not so consistent with legislative policy in the area of stock transactions. Both cases contain statements

94. 1990 La. Acts No. 22, § 1 (amending La. R.S. 12:205.1(B) (Supp. 1990)).

95. 558 So. 2d 333 (La. App. 3d Cir.), writ denied, 561 So. 2d 118 (1990).

96. La. R.S. 10:8-204 (1983). The *Miller* court followed the approach of Thibodeaux v. Pioneer Land Dev. & Realty Co., 420 So. 2d 1162 (La. App. 5th Cir.), writ granted and amended on other grounds, 423 So. 2d 1178 (1982), by interpreting the "actual knowledge" exception in this provision to "augment" the apparently unqualified rule in La. R.S. 12:57(F) (1969) that nonlegended stock transfer restrictions are completely unenforceable. In effect, by interpreting these two provisions to say the same thing, the U.C.C., rather than the provision of the corporate statute, was allowed to control.

97. The court also rejected the argument that the "actual knowledge" exception should not apply to small, closely-held family corporations. 558 So. 2d at 337.

that no writing is required to enforce a purported contract to sell corporate stock.[98] Those statements are not correct. Section 8-319 of the Uniform Commercial Code, adopted in Louisiana in 1978 along with the rest of Article 8, requires that contracts for the sale of securities be in writing.[99] (Corporate stock—even stock in a closely-held corporation—is a "security" for purposes of Article 8.[100]) This statutory writing requirement apparently was not cited to either court. Fortunately, both courts could have reached the results they did without relying on incorrect statements of the law. In one, the court had concluded that no contract had been proven in the first place, so that its statement about a writing requirement was unnecessary to its decision.[101] In the other,[102] the court could have relied on the "partial performance" exception contained in the U.C.C. itself to enforce the contract.[103]

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98. Dupuy v. Riley, 557 So. 2d 703, 707 (La. App. 4th Cir.), writ denied, 563 So. 2d 878 (1990); Pecot v. Pecot, 553 So. 2d 1081, 1083 (La. App. 3d Cir. 1989).

99. La. R.S. 10:8-319 (Supp. 1990).

100. U.C.C. § 8-102 (adopted in Louisiana as La. R.S. 10:8-102 (1983) comment (2)) ("Interests such as the stock of closely-held corporations, although they are not actually traded upon securities exchanges, are intended to be included within the definition of both certificated and uncertificated securities. . . .").

101. 553 So. 2d at 1083.

102. 557 So. 2d at 706-08.

103. La. R.S. 10:8-319(b) (Supp. 1990) (allowing performance to the extent that the shares have been delivered or the purchase price paid). The court found that the purchase price for the stock was the performance of managerial services, and that all of the promised services had been completed.