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Corporate, Securities and Banking Law Aspects of Workouts

BOWMAN BROWN,* BRIAN NORDWALL** AND MICHAEL L. ASHNER***

A corporate workout is any arrangement involving a voluntary restructuring of a debtor-creditor relationship for the purpose of avoiding foreclosure or bankruptcy. The authors discuss certain provisions of Florida's General Corporation Act, Banking Act and securities laws, together with pertinent federal securities laws, to illustrate methods for creating such arrangements. In addition, potential hazards are discussed, with the authors providing useful suggestions for planning and litigation purposes.

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I. INTRODUCTION

The range and variety of transactions that may be realistically defined as "workouts" is enormous. For the limited purposes of this article, a workout is defined as any arrangement involving a voluntary restructuring of a debtor-creditor relationship for the purpose of avoiding foreclosure or bankruptcy. Aside from the debtor and creditor, many other parties may be involved. While the workout process is basically extra-judicial, litigation may occur either as a result of the particular agreement or because the parties fail to reach an amicable settlement of their differences.

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For the purpose of analysis, the workout process may be broken down into phases. The first phase, the negotiation stage, begins with the realization that the enterprise is in trouble. Here, each party analyzes its own liabilities and defenses. Both debtors and creditors search for third parties against whom liability may be asserted. An actual workout situation cannot occur, however, unless all parties affected by the arrangement find the solution to be mutually advantageous.

At this point, the second, or implementation stage occurs. By the time the second stage begins, the parties have decided to restructure their relationship so that the enterprise may continue, hopefully on a profitable course. During this phase, the provisions of applicable state and federal securities and banking laws are crucial and must be examined carefully. This article will reveal the dynamics of these two stages and provide useful suggestions for avoiding potential pitfalls.

II. CERTAIN FLORIDA GENERAL CORPORATION ACT CONSIDERATIONS IN THE NEGOTIATION OF WORKOUTS

A. *Prohibited Disbursements*

Once it has become clear that a project is in trouble, parties controlling the debtor entity may attempt to limit their exposure by reducing their financial stake in the entity. Counsel to both debtor and creditor parties in a potential workout situation should be aware that such activities may run afoul of various provisions of the new Florida General Corporation Act.¹

The Act provides that a corporation may only repurchase shares out of and to the extent of an "unreserved and unrestricted surplus."² Similar restrictions apply to the payment of dividends.³ The new Act does not delineate whether the computation of surplus, which is available for the payment of dividends and redemptions, may be made from consolidated financial statements (as are common in the case of public and more substantial private corporations) or whether each corporate entity considering a distribution must make the computations based upon its own individual unconsolidated financial statements. Regardless of which rule controls, it appears that the end result will be the same because the controlling

1. The Florida General Corporation Act, assigned a chapter 607 designation, was enacted in 1975 Fla. Laws, ch. 75-250, and supersedes FLA. STAT. §§ 608.01-.77, 613.01-.11 (1973)(as amended).

2. FLA. STAT. § 607.017(1) (1977).

3. *Id.* § 607.137.

measure in Florida is a balance sheet test rather than one based on earnings.⁴

The valuation of assets, for the purpose of computing the surplus available for a proper distribution, continues to present a problem under the new Florida General Corporation Act. "Surplus" is defined in the new Act as the excess of "net assets" over "stated capital."⁵ "Net assets" means the amount by which the total assets of a corporation exceed the total liabilities of the corporation.⁶ Unanswered is the question of whether the book or the market value of a corporation's assets is to be utilized in computing "net asset" value.⁷ There is some authority under the former section 608.13 to the effect that "actual market value" of assets may be employed.⁸

The new Act also requires that restrictions and reservations upon surplus must be deducted from "surplus" which would otherwise be available to a corporation for the payment of dividends or the redemption of its shares.⁹ The restrictions and reservations which must be taken into account are not apparent without careful inspection of the new Act. In this context, a corporation may, by resolution of its board of directors, create a reserve or reserves out of its earned surplus for any proper purpose and may abolish any such reserve in the same manner.¹⁰ To the extent that earned surplus or capital surplus is used as the measure of the right of the corporation to purchase its own shares, such surplus is restricted so long as the shares purchased are held as treasury shares.¹¹ The restriction is allocated on a pro rata basis to the treasury shares, and upon the disposition or cancellation of any such shares, the corresponding pro rata restriction is removed.¹²

The new Act prohibits a corporation from purchasing or paying for its own shares at a time when the corporation is insolvent or when such payment would make it insolvent.¹³ Similarly, the payment of a dividend is prohibited if it would result in the insolvency

4. *Id.* § 607.137(1) provides: "Dividends in cash or property may be declared and paid . . . only out of the unreserved and unrestricted earned surplus of the corporation or out of capital surplus, howsoever arising . . ." The statute does not permit payment of dividends out of current earnings when the stated capital is impaired.

5. *Id.* § 607.004(11).

6. *Id.* § 607.004(9).

7. *Id.*

8. See *Baxter v. Lancer Indus., Inc.*, 213 F. Supp. 92 (E.D.N.Y.), *appeal dismissed*, 324 F.2d 286 (2d Cir. 1963), which applied the now outmoded "assets less liabilities and capital" test.

9. FLA. STAT. § 607.211(4) (1977).

10. *Id.*

11. *Id.* § 607.017(2).

12. *Id.*

13. *Id.* § 607.017(4).

of the distributing corporation.¹⁴ Insolvency is defined as the "inability of a corporation to pay its debts as they become due in the usual course of business."¹⁵ The insolvency prohibition on corporate distributions is, therefore, based upon a cash flow test. Because of the interrelationship between the solvency of the corporation and its statutory duty to pay dividends and redeem shares, attempts to forestall corporate creditors through bookkeeping and balance sheet maneuvers may later be deemed admissions of insolvency, and may be used to void corporate distributions prohibited during insolvency.

Prohibitions against equity preferences are also included in the new Act. A corporation may not purchase or pay for its own shares if such a redemption or payment would reduce the net assets of the corporation to the extent that the remaining aggregate net assets are not sufficient to redeem other outstanding redeemable shares having equal or prior rights to the assets of the corporation upon liquidation.¹⁶

The new Act also prohibits certain distributions of corporate assets to shareholders during liquidation. Before filing the articles of dissolution, a corporation must collect its assets, dispose of those assets which are not to be distributed to shareholders in kind, and either pay its liabilities or make provision for payment. Only after this procedure has been completed may the remaining assets be distributed to shareholders.¹⁷

To protect against improper asset distribution, the Act provides for express liability for directors in certain cases. A director who either votes for or assents to a declaration of dividends, a redemption or other shareholder distribution in contravention of either the Act or the articles of incorporation may be subject to liability.¹⁸ Such a director, along with all other directors so voting or assenting, is held to be jointly and severally liable to the corporation.¹⁹ The measure of recovery is determined by the amount of any excess dividend or distribution above that which could have been legitimately paid or distributed if the board had acted in compliance with the law and its own articles of incorporation.²⁰ Recovery is

14. *Id.* § 607.137.

15. *Id.* § 607.004(14).

16. *Id.* § 607.201. What is meant by the term "redeemable shares" is not defined under the new Act, although it is probably safe to assume that it includes only shares which, by their terms, are redeemable by the issuing corporation.

17. *Id.* § 607.261(3).

18. *Id.* § 607.144(1)(a).

19. *Id.*

20. *Id.*

limited, however, to the amount of actual damage which any creditor or shareholder has suffered.²¹

Unsatisfied corporate liabilities secured by distributed property, for the payment of which no reserve is provided by the corporation, may, if unpaid, be satisfied out of the personal assets of directors.²² Various other acts involving possible "distributions" to shareholders, such as a transaction in which a director-shareholder is interested but which has not been properly approved,²³ may also constitute "distributions" to shareholders in violation of the provisions of chapter 607²⁴ and may consequently give rise to joint and several liability on the part of directors.²⁵

B. *Repeal of the Fraudulent Conveyance Statute*

The new General Corporation Act repealed former section 608.55, which stated in part:

No corporation which shall have refused to pay any of its notes or other obligations when due, nor any of its officers or directors, shall transfer any of its property to any of its officers, directors or stockholders, directly or indirectly, for the payment of any debt, or upon any other consideration than the full value of the property paid in cash.²⁶

The section also prohibited any conveyance, assignment, or transfer of any property, sufferance of judgment, giving of security or creation of lien by any officer, director or stockholder, where the corporation was insolvent or imminently insolvent, and where there existed an intent to create a preference to a particular creditor.²⁷ In addition, any party taking under any such prohibited transaction would be liable to the creditors and stockholders, unless the rights acquired were for valuable consideration and without notice or reasonable cause to suspect the nature of the conveyance.²⁸

It is argued that repeal of this provision creates a void in the statutory scheme regulating corporate disbursements, one that may create serious problems for creditors in a workout situation. While those provisions of the new Act as previously discussed regulate various forms of disbursements to shareholders, it appears that

21. *Id.*

22. *Id.* § 607.144.

23. *Id.* § 607.124.

24. *Id.* § 607.144(1)(a).

25. *Id.* § 607.144.

26. FLA. STAT. § 608.55 (1975)(repealed 1976).

27. *Id.*

28. *Id.*

transfers to nonshareholders, which were once regulated under the broader wording of former section 608.55, are no longer required to pass statutory muster. The same result may obtain for some forms of transfers to shareholders where the shareholder takes as a creditor or some other type of transferee.

In attempting to fill the void created by the repeal of section 608.55, practitioners in Florida should consider the example of creditors' counsel from other jurisdictions who have increasingly revived the common law trust fund doctrine to support their claims against corporate debtors.

Although the common law trust fund doctrine is rather inchoate,²⁹ it has been described as follows:

Under the trust fund doctrine, regardless of the differences among the authorities as to the full extent of its implications, it is agreed by the decided weight if not by all of the comparatively recent authorities, that if all of a corporation's assets are disposed of without consideration or distributed among its shareholders, a creditor of the corporation is entitled to pursue those assets on the theory that the assets which he was entitled to look for satisfaction have gotten into other hands under such circumstances as to warrant the view that in equity they are burdened with a lien in his favor.³⁰

In essence, "the assets of the dissolved corporation are a trust fund against which the corporate creditors have a claim superior to that of the stockholders."³¹

It would appear that the common law trust fund doctrine covers acts which lead up to insolvency and then follows the corporate assets until they are transferred to a bona fide purchaser. It imposes a constructive trust or equitable floating lien in favor of creditors.

Section 608.55 was an attempt to codify the "trust fund" doctrine. Indeed, in *Hayes v. Belleair Development Co.*,³² in discussing chapter 10096, the predecessor to section 608.55, the Supreme Court of Florida expressly stated: "The trust fund doctrine as thus stated has been approved and is followed in many states and was incorporated into the law of this state by chapter 10096, § 43, Acts 1925"³³ The court continued, however, limiting the applicability of the doctrine:

29. For a more complete discussion of the finer nuances of this doctrine, see Norton, *Relationship of Shareholders to Corporate Creditors upon Dissolution: Nature and Implications of the "Trust Fund" Doctrine of Corporate Assets*, 30 *BUS. LAW.* 1061 (1975).

30. *Berwick v. Associated Gas & Elec. Co.*, 20 *Del. Ch.* 265, 269, 174 *A.* 122, 123 (1934).

31. *Koch v. United States*, 138 *F.2d* 850, 852 (10th *Cir.* 1943).

32. 120 *Fla.* 326, 162 *So.* 698 (1935).

33. *Id.* at 330, 162 *So.* at 699.

It had not been approved nor followed here prior to this act. . . . Appellee having been organized under the law as it existed prior to the enactment of chapter 10096, Acts 1925, its assets were not a trust fund in the hands of its officers, but could become such only when taken in hand by a court of equity for administration which has not yet been done.³⁴

While this pronouncement would tend to indicate that, since the repeal of section 608.55, no claim under the trust fund doctrine would be entertained by Florida courts, it is argued that there exists considerable authority to support imposition of the common law trust doctrine in the state.

Gray v. Standard Dredging Co.,³⁵ the authority used by the *Hayes* court, in turn relied upon two earlier decisions of the Supreme Court of Florida, *Wheeler v. Matthews*³⁶ and *Guaranty Trust & Savings Bank v. United States Trust Co.*³⁷ Yet, neither of these decisions appears to deny that, when some principle of equity so mandates, the assets of an insolvent corporation may be administered by the court for the benefit of creditors. The cases simply indicate that the mere fact of corporate insolvency does not, in and of itself, create a trust fund.³⁸ While the *Wheeler* court did not find the facts to require exercise of equity jurisdiction in favor of creditors, the *Guaranty Trust* court did, stating:

When a corporation becomes insolvent, in the sense that it is unable to pay its debts, while its assets do not *ipso facto* become a trust estate as to which the corporation or its officers become the trustees and the creditors the *cestuis que trustent*, so that it may be administered as such by a court of equity, such assets may be administered by a court of equity upon the theory that they belong to the creditors rather than to the corporation when the court of equity takes possession of them upon some recognized principle of equity jurisdiction. *The directors, however, of an insolvent corporation occupy toward the creditors of the corporation a fiduciary relation in that the properties of the corporation constitute a fund for the payment of the corporation's debts which fund the directors are charged with managing to the best interests of the creditors.*³⁹

It should be noted that in *Guaranty Trust*, the court exercised

34. *Id.* (citation omitted).

35. 109 Fla. 87, 149 So. 2d 733 (1933).

36. 70 Fla. 317, 70 So. 416 (1915).

37. 89 Fla. 324, 103 So. 620 (1925).

38. *Id.* at 330-31, 103 So. 2d at 622; *Wheeler v. Matthews*, 70 Fla. 317, 321-22, 70 So. 416, 418 (1915).

39. 89 Fla. at 330-31, 103 So. at 622 (emphasis added).

equity jurisdiction over an already existing, contractually created fund for the benefit of creditors. A similar situation occurred in *Beach v. Williamson*,⁴⁰ where the directors of an insolvent corporation had obtained a conveyance of all corporate property in exchange for a promise to pay the corporation's debts. While the court in *Beach* based its finding of equity jurisdiction on fraud, it stated more generally that directors of a corporation are "bound to exercise diligence and good faith in dealing with the properties of the corporation, to the end that the creditors' interests may be protected."⁴¹ No such finding of fraud or a contractually created fund for the benefit of creditors was required by the court in *Forcum v. Symmes*.⁴² While the result in *Forcum* could have been reached on statutory grounds, the court apparently chose to exercise its equity jurisdiction. In so doing it nullified a transaction in which, pursuant to a directors' resolution, promissory notes, mortgages and other security were returned to stockholders who in turn transferred their stock certificates to the corporation. The court, citing *Beach* and *Guaranty Trust*, reasoned that the defendant officers and directors had failed to exercise diligence and good faith in managing the property of the corporation, and had thus impaired the interests of creditors.⁴³

Finally, it should be noted that former section 608.55 was not specifically singled out for repeal by the legislature; rather, it was repealed as part of a general repeal of chapter 608.⁴⁴ While the repeal of section 608.55 leaves the status of the trust fund theory in doubt, favorable language in *Wheeler*, *Guaranty Trust*, *Forcum* and *Beach*, as well as widespread utilization of the doctrine in a number of other jurisdictions,⁴⁵ provides a basis for arguing for the imposition of a floating lien in favor of creditors upon the assets of an insolvent Florida corporation.

C. Certain Partnership Arrangements

An examination of partnership cases, in which the status of individual partners as creditors is discussed, indicates that a partner may not share in the assets of the partnership with third party

40. 78 Fla. 611, 83 So. 860 (1920).

41. *Id.* at 620-21, 83 So. at 863.

42. 106 Fla. 510, 143 So. 630 (1932).

43. *Id. passim.*

44. Fla. Laws 1975, ch. 75-250 amending FLA. STAT. §§ 608.01-.77 (1973).

45. See, e.g., *United States v. F.D. Rich Co.*, 437 F.2d 549 (9th Cir. 1970); *Snyder v. Nathan*, 353 F.2d 3 (7th Cir. 1965); *King v. Coosa Valley Mineral Prod. Co.*, 283 Ala. 197, 215 So. 2d 275 (1968); *Zinn v. Bright*, 9 Cal. App. 3d 193, 87 Cal. Rptr. 736 (Ct. App. 1970); *Wortham v. Lachman-Rose Co.*, 440 S.W. 2d 351 (Tex. Civ. App. 1969).

creditors. In *In re Effinger*,⁴⁶ the court clearly enunciated this principle, stating:

So far as I have been able to discover, the reports do not disclose more than five cases in which it has been claimed that the partner or his individual estate could participate in the distribution of the firm assets in competition with firm creditors. Wherever the claim has been made, it has been denied.

. . . A partner cannot swell the assets of his firm by contributing money or property to it, and then, when the firm becomes insolvent, assert, either in his own interest or that of his individual creditors, that what he had put into the firm was a mere loan to it, and was not part of its assets.⁴⁷

To avoid the problem discussed above, it has become common for those contemplating dual creditor-partner status to make the loan to the partnership from a parent corporation, and to form a subsidiary of the parent-creditor to serve as partner. This, of course, raises the possibility that the corporate veil may be pierced. The Florida courts have held that in the parent-subsiary situation, the circumstances surrounding the relationship may be such that one corporation may be the mere instrumentality or agent of another to the extent that the legal identity of the corporations is the same. Although the plaintiff creditor did not succeed in piercing the corporate veil in *Mayer v. Eastwood-Smith & Co.*,⁴⁸ the Supreme Court of Florida indicated that the courts will impose individual liability where "the corporation was a mere device or sham to accomplish some ulterior purpose, or is a mere instrumentality or agent of another corporation or individual owning all or most of its stock, or where the purpose is to evade some statute or to accomplish some fraud or illegal purpose."⁴⁹

In the case of *State ex rel. Continental Distilling Sales Co. v. Vocelle*,⁵⁰ which involved liquor licensing, the court sought to limit the sweeping statements made in *Mayer*:

Corporations are legal entities by fiction of law. Their purpose is generally to limit liability and serve a business convenience. Courts are reluctant to pierce the corporate veil and only in exceptional cases will they do so. Such instances are for fraud *as*

46. 184 F. 728 (D. Md. 1911).

47. *Id.* at 731, 734.

48. 122 Fla. 34, 164 So. 684 (1935).

49. *Id.* at 43, 164 So. at 687. See also *Mabel Whayne v. Transp. Mgt. Serv., Inc.*, 252 F. Supp. 573 (E.D. Pa. 1966).

50. 158 Fla. 100, 27 So. 2d 728 (1948).

where creditors are misled and defrauded or where the corporation is created for some illegal purpose or to commit an illegal act.⁵¹

While the language in *Mayer* should serve as a caution to counsel structuring a dual creditor-partner status transaction, it is clear that the restrictive language in *Continental Distilling* more closely represents the general view in Florida and other jurisdictions.

III. BANKING AND CORPORATE LAW CONSIDERATIONS

A. *The Florida Banking Code and Non-Florida Banks*

A significant number of workouts of Florida real estate projects involve indebtedness to a non-Florida bank. Substantial problems may arise for the out-of-state bank in attempting to restructure indebtedness of Florida entities because of restrictive banking code provisions which severely limit the activities in which a non-Florida bank may engage in Florida.

The Florida Banking Code⁵² requires that a certificate of authority be secured under section 659.05(3)(a)⁵³ before banking or trust business may be done in Florida. Such a certificate will not be issued to a non-Florida corporation. Out-of-state banks engaging in activities in Florida may, therefore, engage only in activities not requiring a certificate of authority.

Sections 659.57⁵⁴ and 660.10⁵⁵ provide limited lists of activities which may be undertaken within Florida by out-of-state banks and trust companies, without being deemed the conduct of banking or trust business in Florida. Included in the permitted list is a broad range of transactions designed to enable out-of-state lenders to protect their interests in collateral securing loans made in Florida. In general, section 659.57(1)(c)⁵⁶ allows a non-Florida bank lender to deal with, manage or convey property in Florida which it has acquired as security for, or in satisfaction of, obligations otherwise acquired in accordance with the provisions of the section.

51. *Id.* at 102, 27 So. 2d at 729 (emphasis added). For a case in which the veil of a joint venturer was pierced, see *Lurie v. Arizona Fertilizer & Chem. Co.*, 101 Ariz. 482, 421 P.2d 330 (1966), where the court found a lack of corporate authority to enter into the joint venture, undercapitalization of the corporate venturer and possible fraud on the part of the stockholders in creating the impression that they were joint venturers. See also *Aztec Motel, Inc., v. State ex rel. Faircloth*, 251 So. 2d 849 (Fla. 1971) (citing *Mayer v. Eastwood-Smith & Co.*, 122 Fla. 34, 164 So. 684 (1935)).

52. See generally FLA. STAT. §§ 658.01-.11, 659.01-.67, 660.01-.23, 661.01-.44 (1977).

53. *Id.* § 659.05(3)(a).

54. *Id.* § 659.57.

55. *Id.* § 660.10.

56. *Id.* § 659.57(1)(c).

It is apparent that the only loan transaction in which a non-Florida bank may participate under the terms of section 659.57 is an arrangement which has been made in Florida by an entity other than the out-of-state bank and which has been acquired by the out-of-state bank by assignment or participation. Security interests relating to any such loan may also be acquired, but only by assignment or participation.

Sections 659.57 and 660.10 of the Banking Code, however, do not readily accommodate a variety of workout formats. The extension of new credit in connection with a workout arrangement, for example, may not be permissible if new notes and separate security are involved. Consolidation of indebtedness and rearrangement of out-of-state participations in the indebtedness may also run afoul of section 659.57.

While sections 659.57 and 660.10 clearly place definite constraints on the flexibility of a non-Florida bank in the workout context, certain changes wrought by the new corporation act may serve to expand the forms of activity in which these banks may engage.

Until January 1, 1976, chapter 613 of the Florida Statutes applied to the transaction of business in Florida by out-of-state corporations, with the explicit exception of banks and trust companies.⁵⁷ Effective January 1, 1976, chapter 613 was repealed, and relevant provisions were included in the new General Corporation Act.⁵⁸ The new Act includes a list of activities which are deemed not to constitute the transaction of business in Florida by a foreign corporation.⁵⁹ But, unlike former chapter 613, the new Act does not specify that foreign banks and trust companies may *not* qualify to do business in Florida under the general provisions of the law relating to the qualification of out-of-state corporations.

In spite of this apparent omission, it is unlikely that an out-of-state bank or trust company could qualify to do traditional banking or trust business in Florida under section 607.304⁶⁰ of the new corporation act. It would appear, however, that the inclusion of the list of activities of out-of-state corporations deemed not to constitute doing business in Florida, and the absence of specific exemption of out-of-state banks and trust companies from the application of this section could bolster the argument that the provisions of sections

57. FLA. STAT. §§ 613.01-.11 (1975) (repealed by Fla. Laws 1975, ch. 75-250).

58. See generally FLA. STAT. §§ 607.304-.367 (1977).

59. *Id.* § 607.304(2). Examples of activities which are deemed not to constitute the transaction of business in this state by a foreign bank include: (a) maintaining or defending any action or suit in this state; (b) holding meetings of its directors or shareholders in this state; and (c) maintaining bank accounts in this state.

60. *Id.* § 607.304.

659.57 and 660.10 are nonexclusive and that different definitions as to what constitutes transacting business in Florida should not be applied to out-of-state banks and trust companies.

If this is the case, then the new list of activities in which a foreign corporation is permitted to engage in Florida without qualification to do business here, as set forth in section 607.304,⁶¹ may provide some standards for judging the permissible scope of workout formats which may be adopted by non-Florida banks with regard to Florida loans. In this connection, the section indicates that a foreign corporation will not be deemed to be transacting business in Florida by engaging in the following activities:

(g) Creating, as borrower or lender, or acquiring, indebtedness, mortgages, or other security interests in real or personal property.

(h) Securing or collecting debts or enforcing any rights in property securing the same.

(i) Transacting any business in interstate commerce.

(j) Conducting an isolated transaction completed within a period of 30 days and not in the course of a number of repeated transactions of like nature.⁶²

It is argued that this broader view of the scope of permissible non-Florida bank activity is in the public interest. By facilitating workouts, projects will be salvaged, capital preserved and litigation avoided. Tax revenue will be increased in the many instances where the workout candidate eventually becomes profitable. Furthermore, it would seem likely that an expansion of permissible activities by non-Florida banks would increase the flow of capital into the state both within and without the workout context.

Even if a certain activity appears to be in violation of the Florida Banking Code, it may be argued that the violation may not impair the validity of the transaction involved, since there are no provisions of the Banking Code which indicate that transactions in violation of the provisions of the Code are void or voidable. Still, an injunction may be secured against any such violator and, in the case of an act or omission expressly declared to be unlawful or a criminal offense under the provisions of the Banking Code, the violator may be found guilty of a second degree misdemeanor.⁶³

In an attempt to avoid the difficulties created by the limitations imposed on the activities of out-of-state banks in Florida by the Banking Code, out-of-state banks engaged in workout transac-

61. *Id.*

62. *Id.*

63. *Id.* §§ 659.55-56.

tions sometimes structure them so that wholly owned nonbank subsidiary corporations, which presumably are not subject to the restrictions of the Banking Code on lending activities in Florida, and which may qualify to do business in Florida or which are qualified to do business here, acquire interests in the workout or manage the property involved. If a subsidiary which is qualified to do business in Florida is utilized, it will be subject to the Florida corporate income tax.⁶⁴

In the event that an out-of-state bank itself manages or retains an interest in the workout, the bank will be subject to Florida income tax on taxable income apportioned to Florida only if all of the bank's tax base attributable to Florida activities is not subject to taxation by the state of its domicile.⁶⁵ This represents a departure from previous law which flatly exempted an out-of-state bank from taxation in Florida.⁶⁶

B. Accommodations and Guarantees

Problems involving guarantees and accommodations may arise in both stages of the workout process. During the first stage, guarantors and accommodation parties will want to consider defenses to claims made against them in those capacities. During the second stage of the workout process, the creditor parties may seek guarantees or accommodations from entities affiliated with the debtor.

The general rule is that in the absence of specific authority to the contrary in either its certificate of incorporation or its bylaws, a corporation does not have the power to become an accommodation party or maker on a note.⁶⁷ In the absence of statutory authority, there is no implied authority for such power.

Two Florida cases dealt indirectly with this problem. In *J. Schnarr & Co. v. Virginia-Carolina Chemical Corp.*,⁶⁸ Virginia-Carolina executed a note as an accommodation maker for another company in favor of a payee who knew of the accommodation nature of Virginia-Carolina's execution. In holding that the payee had no cause of action against the corporate accommodation maker, the court indicated that an agent or an officer of a corporation has no implied authority to bind the corporation by an accommodation

64. *Id.* § 220.11. The subsidiary's taxable income will be apportioned to Florida by means of a formula which ascribes a weight of 50% to Florida sales, 25% to Florida payroll and 25% to Florida property. *See id.* § 220.15.

65. *Id.* § 220.69.

66. FLA. STAT. § 220.61 (Supp. 1972)(repealed by Fla. Laws 1973, ch. 73-152).

67. 6 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 2631 (rev. perm. ed. 1968).

68. 118 Fla. 258, 159 So. 39 (1934).

endorsement; that, even assuming that the corporation had power to execute negotiable paper, the issue of a note for accommodation is an abuse of power when paper is issued without authority; and that, as a consequence, the right of the holder to recover depends on whether he was ignorant of the fact that the paper was for accommodation and was otherwise a holder in due course.⁶⁹

A similar question was considered in *Citizens' National Bank of Fernandina v. Florida Tie & Lumber Co.*,⁷⁰ in which the lumber company's treasurer executed three promissory notes payable to a partnership in which he was a partner. The partnership indorsed the notes before maturity to plaintiff, Citizens' Bank, which discounted the notes and later sued the lumber company on the notes when they were not paid at maturity. The court charged Citizens' with knowledge of the fact that the treasurer had no authority from the lumber company to execute the notes since Citizens' had transacted a significant amount of business with the treasurer in his alternate capacity as a partner. The notes were accommodation notes for the purpose of lending the lumber company's credit to the partnership with no consideration being received by the lumber company. Thus, the plaintiff was not a holder in due course and was not entitled to recover on the notes from the defendant lumber company.

In reaching this decision, the court in *Citizens'* rather cryptically assumed that the issuance of accommodation paper by a corporation is not strictly an ultra vires act, but rather an act which merely exceeds the limit of the corporation's power and that the paper so issued is valid in the hands of a bona fide holder.⁷¹

Section 3-415 of the Florida Uniform Commercial Code provides that "[a]n accommodation party is one who signs the instrument in any capacity for the purpose of lending his name to another party to it."⁷² It further provides that when the instrument has been taken for value before it is due, the accommodation party is liable in the capacity in which he has signed even though the taker knows of the accommodation. It might be argued that this section should be construed as the requisite statutory authority to permit a corporation to act as an accommodation party.

This approach has failed elsewhere. In a New York decision, *Oppenheim v. Simon Reigel Cigar Co.*,⁷³ a bank discounted notes which had been indorsed by the payee, Simon Reigel, for the maker.

69. *Id.* at 270, 159 So. at 43.

70. 81 Fla. 880, 89 So. 139 (1921).

71. *Id.* at 900-01, 89 So. at 143.

72. FLA. STAT. § 673.415(1) (1977).

73. 90 N.Y.S. 355 (App. Div. 1904).

The bank later assigned the notes to the plaintiff, but the indorsement was found to be for accommodation and not within the corporation's power. The New York court held that a corporation which is otherwise without power to make an accommodation indorsement is not provided such power by a statute defining an accommodation party and providing that such person is liable on the instrument to a holder for value, though such holder takes with knowledge that the corporation is only an accommodation party.⁷⁴

While the law appears settled that a parent corporation may guarantee the obligations of its subsidiary,⁷⁵ it is unclear whether a subsidiary may guarantee the obligations of a sister corporation or of the parent. The latter arrangement involves the guarantee by a corporation of the debts of a shareholder, a practice forbidden in a number of jurisdictions.⁷⁶

The new Florida General Corporation Act has not resolved this issue. While both the old and the new Acts indicate that Florida corporations may issue guarantees and mortgage their property,⁷⁷ it would appear that such language is merely intended to be enabling, and that the arrangement must be supported by fair consideration or have an otherwise valid business purpose. *Alliegro v. Pan American Bank*⁷⁸ implicitly espouses this view. There, the question was whether a parent corporation could validly guarantee the value of the assets of an eighty percent owned subsidiary in order to avert possible Federal Reserve Board action. On these facts, the court found that the parent's interest in the subsidiary empowered the corporation to make the guaranty and was sufficient consideration to permit its full enforcement. Had the statute alone been sufficient to fully supply the guarantee power, the court's discussion would have been unnecessary.⁷⁹

There are no Florida cases to date discussing whether a subsidiary may guarantee the obligations of its parent or of a sister corporation. However, the commentaries to the Model Business Corporation Act, from which the Florida provisions regarding corporate powers were derived, point out that "most of the cases, particularly

74. A similar conclusion was reached in *New Hampshire Nat'l Bank v. Garage & Factory Equip. Co.*, 267 Mass. 483, 166 N.E. 840 (1929).

75. *Alliegro v. Pan Am. Bank*, 136 So. 2d 656 (Fla. 3d Dist. 1962), *cert. denied*, 149 So. 2d 45 (Fla. 1963).

76. *Crossland-Cullen Co. v. Philadelphia Life Ins. Co.*, 133 F. Supp. 473 (W.D.N.C.), *rev'd on other grounds*, 234 F.2d 780 (4th Cir. 1955); *In re Romadka Bros. Co.*, 216 F. 113 (7th Cir. 1914).

77. Compare FLA. STAT. § 608.13(9)(a) (1975)(repealed 1976) with FLA. STAT. §§ 607.011(2)(c) and 607.237 (1977).

78. 136 So. 2d 656 (Fla. 3d Dist. 1962), *cert. denied*, 149 So. 2d 45 (Fla. 1963).

79. See *id.* at 662-64.

the older cases, which have held guarantees invalid, were based on the ultra vires theory."⁸⁰ The courts, in view of that theory's decline, gradually turned to the doctrine of consideration as the validating criterion. Today, the criterion should be less technical. Guarantees should be upheld if it is shown that the board of directors of the guarantor had in good faith, and in the exercise of reasonable business judgment, decided that the benefits derived from the guarantees were sufficient to justify the liability incurred.

Section 3-416 of the Florida Uniform Commercial Code,⁸¹ which deals with guarantees, indicates that a holder of guaranteed negotiable paper may, as in the case of a holder of an instrument executed by an accommodation maker, have an enforceable obligation. Furthermore, section 607.021 of the Florida Corporation Act states in its preamble: "No act of a corporation . . . shall be invalid by reason of the fact that the corporation was without capacity or power to do such act or to make or receive such conveyance, transfer, or encumbrance. . . ."⁸² These two statutes, taken together with section 3-415, dealing with accommodation parties, would appear to limit the usefulness of an ultra vires defense to debtors in a potential workout situation.

Certain other provisions of section 607.021, however, enumerate limited circumstances under which the lack of corporate power may be asserted as a defense. This may give rise to very significant liabilities during the second stage of the workout process, when guarantees or accommodations may be sought by creditors.⁸³ Thus, for those who seek to implement a workout, the corporate power question presented by subsidiary guarantees and accommodations remains open.

C. *Substantial Disposition of Assets*

Not infrequently the implementation of a workout arrangement will include passage of a deed in lieu of foreclosure to the creditors.

80. MODEL BUS. CORP. ACT § 4(h), comment (1960).

81. FLA. STAT. § 673.416 (1977).

82. *Id.* § 607.021.

83. Section 607.021 states that lack of corporate power *may* be asserted:

(1) In a proceeding by the corporation, whether acting directly or through a receiver, trustee, or other legal representative, or through shareholders in a representative suit, against the incumbent or former officers or directors of the corporation.

(2) In a proceeding by the Attorney General, . . . to dissolve the corporation or in a proceeding by the Attorney General to enjoin the corporation from the transaction of unauthorized business.

Id. § 607.021.

Very often, the deeded property constitutes all or substantially all of the debtor's assets.

Section 607.241 of the new General Corporation Act requires approval by directors and shareholders in the event of a "sale, lease, exchange, or other disposition of all, or substantially all, the property and assets of a corporation, with or without the good will."⁸⁴

A deed in lieu of foreclosure conveying a substantial portion of the operating assets or property of a corporation would probably constitute a "sale, lease, exchange, or other disposition,"⁸⁵ thus requiring approval by the directors and shareholders. Less certain is the question of what other types of arrangements would constitute an "other disposition" requiring shareholder approval, although it is clear that the directors of a corporation alone may mortgage all of its assets.⁸⁶ Potential individual liability of directors under the new General Corporation Act for ultra vires acts of a corporation⁸⁷ suggests that director *and* shareholder approval must be secured where there is any reason for doubt.

While there are no Florida cases construing the meaning of the term "substantially all," cases from other jurisdictions interpreting similar language indicate that the courts may scrutinize both the amount of assets and their nature, placing special emphasis upon assets that are necessary to the conduct of normal corporate affairs.⁸⁸

The new Act permits shareholders to dissent from "[a]ny sale or exchange of all or substantially all of the property and assets of the corporation, including a sale in dissolution."⁸⁹ It is unclear whether the language providing that "lease or other disposition" of all or substantially all the assets requiring shareholder approval under section 607.241 was *intentionally* deleted from the section pertaining to dissenting shareholders' rights. In the absence of any authority, one might speculate whether a deed in lieu of foreclosure would be subject to the dissenters' rights.

IV. SECURITIES LAWS: STATE AND FEDERAL

The ambit of the securities laws is such that few substantial efforts to raise capital escape their application. Since a large num-

84. *Id.* § 607.241.

85. *See id.*

86. *Id.* § 607.237.

87. *Id.* § 607.021.

88. *See Id.* § 607.241. For example, in *Stiles v. Aluminum Prods. Co.*, 338 Ill. App. 48, 86 N.E.2d 887 (1949), a corporation which retained only incidental assets, but which disposed of most, if not all, operating assets, was deemed to have sold "substantially all" its assets.

89. FLA. STAT. § 607.244 (1)(b) (1977).

ber of workout situations encountered in Florida involve real estate projects, they constitute a useful illustration of the wide range of securities problems that must be anticipated by the practitioner.

If a transaction involves a "security," the state⁹⁰ and federal⁹¹ regulatory frameworks become operative. Unless the security or the transaction in which it is distributed falls within one of the specific statutory exemptions,⁹² the issuer must register with the appropriate state and federal agencies.⁹³ In addition, regardless of whether or not the security needs to be registered, the issuer must ensure that every material fact which a reasonably prudent investor would consider in connection with the sale or purchase of said security is disclosed.⁹⁴ Furthermore, all persons who sell or offer for sale securities for the account of another must be registered at both the state⁹⁵ and federal⁹⁶ levels, unless specifically exempted. Failure to comply with these regulatory requirements may result in severe penalties, both civil and criminal.⁹⁷

A. *What is a Security?*

The regulatory framework does not, for the most part, become relevant unless a threshold determination is made that the item sold constitutes a security.⁹⁸ Both the Florida and federal securities laws define a security in such a broad manner that the practitioner must take great care to ensure that the instrument offered for sale does not fall within the statutory intendment. In addition, judicial construction has served to expand the definition still further.

In the landmark case of *SEC v. W.J. Howey Co.*,⁹⁹ the Supreme

90. *See Id.* §§ 517.01-.363 (1977).

91. *See* 15 U.S.C. §§ 77a-80b-20 (1976).

92. 15 U.S.C. §§ 77c-77d (1976); FLA. STAT. §§ 517.05-.06 (1977).

93. 15 U.S.C. § 77f (1976); FLA. STAT. § 517.07 (1977).

94. 15 U.S.C. § 77g (1976); FLA. STAT. § 517.301 (1977).

95. FLA. STAT. § 517.12 (1977).

96. 15 U.S.C. § 78o (1970).

97. *See, e.g.*, 15 U.S.C. §§ 77k, 77l, 77t, 77x, 78r (1976); FLA. STAT. §§ 517.16, .21-.23, .302 (1977).

98. *See* FLA. STAT. § 517.02(1) (1977). The federal provision is almost identical, and it provides that a "security" is

any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

15 U.S.C. § 77b(1) (1976).

99. 328 U.S. 293 (1946).

Court of the United States held that an "investment contract" is the investment of money with the expectation of profits to come solely through the efforts of others. This construction, together with the statutes' literal language, has often resulted in the classification of interests distributed in workout arrangements as securities.

Since state law provides for the forfeiture of a limited partner's limited liability if he participates to any extent in the management or operation of the partnership,¹⁰⁰ limited partnership interests are almost by definition passive investments and, thus, securities. Moreover, even general partnership interests may be treated as securities if the operation or management of the property is vested in less than all of the general partners or in a third party.¹⁰¹ Interests in a joint venture become securities if the operation or management is handled in a similar fashion. The same result occurs in an agreement under which a seller of an undivided interest in real property retains control and overall management of the property.¹⁰² As one may observe, common to these arrangements is a delegation of control to someone other than the investor, thus bringing the transaction squarely within the *Howey* framework. On the other hand, no security will be involved where the buyer and the seller structure the transaction so that the seller retains no management rights and does not participate in any future benefits, and where the owners agree that any act affecting the entire enterprise must be approved by a majority.¹⁰³

Certain instruments not commonly recognized as securities may, under the circumstances of a particular transaction, assume such a status. For example, a written letter of commitment was held to be a security where the letter purported to provide a first mortgage and was subsequently "sold for a substantial consideration," the buyer receiving what appeared to be an enforceable obligation which contemplated the holding of funds.¹⁰⁴ Similarly, the Securities Exchange Commission has viewed a guarantee to purchase a security as itself a security.¹⁰⁵

100. See FLA. STAT. § 620.07 (1977); *Murphey v. Hillwood Villa Assoc.*, 411 F. Supp. 287 (S.D.N.Y. 1976).

101. See, e.g., *Pawgan v. Silverstein*, 265 F. Supp. 898 (S.D.N.Y. 1967).

102. SEC No-Action Letter [1972-1973 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 78,882.

103. See, e.g., *SEC v. Royal Hawaiian Management Corp.*, [1966-1967 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 91,982 (C.D. Cal. 1967).

104. *United States v. Austin*, 462 F.2d 724 (10th Cir.), cert. denied, 409 U.S. 1048 (1972). See also *Lawrence v. SEC*, 398 F.2d 276 (1st Cir. 1968), holding that a commitment to issue a security is itself a security.

105. *Georgia Int'l Corp.*, [1972-1973 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 78,810.

Another aspect of the foregoing problem is the characterization of notes issued by an obligor as part of the workout. Section 3(a)(3) of the Securities Act of 1933¹⁰⁶ exempts from registration notes issued to finance current transactions. According to the SEC, this exemption "applies only to prime quality negotiable commercial paper of a type not ordinarily purchased by the public."¹⁰⁷ Section 3(a)(10) of the Securities Exchange Act of 1934¹⁰⁸ also excludes from its definition of a security "any note . . . which has a maturity at the time of issuance of not exceeding nine months." Federal courts, in determining whether or not notes are securities, have begun to apply a more elastic test, focusing on whether the note is predominantly "commercial" or "investment"¹⁰⁹ in character, rather than with reference to any mechanical standards set forth in the federal laws.

The United States Court of Appeals for the Fifth Circuit has been especially active in this area, beginning with *Bellah v. First National Bank of Hereford*¹¹⁰ in 1974. In *Bellah*, the Fifth Circuit stated that maturity alone was not determinative of the nature of an instrument issued under the 1934 Act. Looking to the intention of the issuer, the court found no investment intent and thus held that the notes offered were not securities. Later, in *SEC v. Continental Commodities Corp.*,¹¹¹ the Fifth Circuit set forth several factors as relevant in determining whether an instrument should be considered as exempt commercial paper or nonexempt investment paper: (1) whether the notes are prime quality; (2) whether they were used to finance current transactions; (3) whether they were offered to the public; and (4) whether they could be discounted by a Federal Reserve Bank.¹¹² Applying these factors to the situation before it, the court held that notes maturing in less than nine months issued by a broker to its customers as partial reimbursement for losses sustained by them in connection with discretionary trading accounts and commodity options were nonexempt securities. Within a week of *Continental Commodities*, a different Fifth Circuit panel completed the picture by holding that notes maturing more than nine months after issuance were not securities under the 1934

106. 15 U.S.C. § 77c(a)(3) (1976).

107. SEC Release No. 33-4412, 26 Fed. Reg. 9158-59 (1961).

108. 15 U.S.C. § 78c(a)(10) (1976).

109. See, e.g., *Bellah v. First Nat'l Bank*, 495 F.2d 1109 (5th Cir. 1974).

110. *Id.* The court also noted that the commercial paper exemptions of the 1933 and 1934 Acts were basically identical and, therefore, the standards developed under the former could be applied to the latter. *Id.* at 112.

111. 497 F.2d 516 (5th Cir. 1974).

112. *Id.* at 525.

Act definition.¹¹³ The court expressly stated, "the investment or commercial nature of a note entirely controls the applicability of the Act, depriving of all utility the exemption based on maturity-length."¹¹⁴

B. "Offer or Sale"

If securities are involved in a workout, a second threshold question arises before federal and state securities regulations apply; whether the transaction involved the "offer or sale" of the security. As with the term "security," "offer or sale" has been defined broadly in the context of securities regulation.¹¹⁵ No liability will arise under the various securities acts unless the court finds that either an offer or sale of a security has occurred.

Undoubtedly, the issuance of a security in payment of an obligation is an issuance for value and, therefore, a sale within the meaning of the 1933 Act. Moreover, a pledge of securities by a pledgor may also constitute a sale, at least in the view of the SEC.¹¹⁶ Indeed, the mere exchange of securities for another interest, such as a limited partnership interest, will be treated as a sale of a security, whether new financing is contemplated or not.¹¹⁷

One problem which may be encountered in the workout context is the possible treatment of a forfeiture as a sale, thus requiring full disclosure of all material information and, possibly, registration. In *Murphy v. Hillwood Villa Associates*,¹¹⁸ the United States district court held that a sale occurred upon the operation of a relatively common provision in a limited partnership agreement requiring transfer of the limited partners' capital contribution to the general

113. *McClure v. First Nat'l Bank*, 497 F.2d 490 (5th Cir. 1974), *cert. denied*, 420 U.S. 930 (1975). There, the court held that a \$200,000 bank loan to a two-shareholder corporation, evidenced by the corporation's one year promissory note, and secured by a pledge of stock, was a commercial transaction not covered by the federal securities laws. For a discussion of the securities implications involved in discretionary accounts, see Comment, *Discretionary Accounts*, 32 U. MIAMI L. REV. 401 (1978).

114. *McClure v. First Nat'l Bank*, 497 F.2d 490, 495 (5th Cir.), *cert. denied*, 420 U.S. 930 (1975). See also *Zabriskie v. Lewis*, 507 F.2d 546 (10th Cir. 1974); *Lino v. City Investing Co.*, 487 F.2d 689 (3d Cir. 1973); *Hammett, Any Promissory Note: The Obscene Security, A Search for the Non-Commercial Investment*, 7 TEX. TECH. L. REV. 25 (1975); *Lipton & Katz, "Notes" are not Always Securities*, 30 BUS. LAW. 763 (1975); *Lipton & Katz, "Notes" are (are not?) Securities—A Review*, 29 BUS. LAW. 861 (1974); Comment, *Commercial Notes and Definition of 'Security' under Securities Exchange Act of 1934: A Note is a Note is a Note?*, 52 NEB. L. REV. 478 (1973).

115. See, e.g., 15 U.S.C. § 77b(3) (1976); FLA. STAT. § 517.02(3) (1977).

116. *SEC v. National Bankers' Life Ins.*, [1972-1973 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 93,738.

117. *United States v. Wernes*, 157 F.2d 797, 799 (7th Cir. 1946).

118. 411 F. Supp. 287 (S.D.N.Y. 1976).

partner in the event of default by the limited partners upon their obligation to make additional contributions of capital. In reaching this conclusion, the court noted that under the 1934 Act, the definition of sale included a contract to sell, and that, although unconventional, the transaction nonetheless involved "mutual promises," the nonperformance of which gives rise to a remedy for breach.¹¹⁹ Moreover, since the agreement provided for forfeiture upon the occurrence of certain conditions, there was thus a "contract to dispose of" a security, thereby invoking the securities laws.¹²⁰

Counsel to a party to any workout transaction involving installment payments should be aware that each payment pursuant to an installment purchase contract for the purchase of a security is subject to the independent and individual satisfaction of the full disclosure requirements of rule 10b-5.¹²¹ Under certain circumstances, installment payment arrangements for the purchase of securities have been held to involve individual and separate "sales" of securities.¹²² In this situation, each installment payment is separately subject to the registration requirements and other provisions of the 1933 Act.

C. Exemptions from Registration

Where there is an offer or sale of a security, the substantial expense of registration may be avoided if the transaction qualifies for one of the statutory exemptions. Moreover, in practice the exigencies and economics associated with a normal workout result either in the transaction being consciously structured to avoid registration or in registration being unnecessary through the use of an exemption.

The two most popular exemptions are private placements¹²³ and intrastate offerings.¹²⁴ As a practical matter, use of these exemptions requires compliance with SEC regulations specifically designed to implement what the Commission feels the securities laws ought to accomplish.¹²⁵

119. *Id.* at 293.

120. *Id.*

121. 17 C.F.R. § 240.10b-5 (1977); see 4 L. Loss, *SECURITIES REGULATION* 2575 (2d ed. Supp. 1969). See also *United States v. Kormel Inc.*, 230 F. Supp. 275, 278 (D. Nev. 1964).

122. *SEC v. Royal Hawaiian Management Corp.* [1966-1967 Transfer Binder] *FED. SEC. L. REP. (CCH)* ¶ 91,982 (C.D. Cal. 1967); *SEC v. North Am. Fin. Co.*, 214 F. Supp. 197 (M.D. Ark. 1959).

123. Securities Act of 1933 § 4(2), 15 U.S.C. § 77d(2) (1976); see *FLA. STAT.* § 517.06(10) (1977).

124. *Id.* § 3(a)(11), 15 U.S.C. § 77c(a)(11) (1976).

125. For private placements, SEC Rule 146, 17 C.F.R. § 230.146 (1977), provides the guidelines, while Rule 147, 17 C.F.R. § 230.147 (1970), is the standard for the intrastate

Apart from the difficulty of compliance with the requirements of both exemptions, there is the additional problem of integration. Under certain circumstances, offerings which appear to qualify for an exemption may be integrated with one another or with nonqualified or registered offerings and thereby fail by reason of such integration.¹²⁶ With respect to real estate syndications, the Commission's position appears to favor a finding of integration.

In summary, although a paramount consideration in a workout is the avoidance of the costs and delay attendant to registration, the establishment of an exemption will require the practitioner to pay painstaking attention to detail, to prepare significant amounts of documentation and to keep closely abreast of recent developments in the field of securities regulation.

D. Broker-Dealer Registration

One of the most neglected areas of securities regulation, particularly in connection with real estate syndications, involves broker-dealer registration. The general rule under the Securities Exchange Act of 1934 is that any person who effects a transaction in securities for the account of another must be licensed as a broker-dealer unless specifically exempted.¹²⁷ Especially pertinent to real estate syndication is the current SEC position that the professional syndicator may be subject to registration because he is not viewed as falling within the issuer exemption of the 1934 Act.¹²⁸ In addition, an administratively created exemption for holders of individual notes or bonds secured by lien or real estate has been revoked by the SEC.¹²⁹ Furthermore, the intrastate exemption for broker-dealers whose

offering exemption. Even if the expressed provisions of the rules are followed, the Fifth Circuit has stated that the general provisions of the rules will generally be used as a standard to determine whether the issuer deserves the exemptions' protection. *Woolf v. S.D. Cohn & Co.*, 515 F.2d 591 (5th Cir. 1975), *vacated on other grounds*, 426 U.S. 944 (1976). See also *Doran v. Petroleum Management Corp.*, 545 F.2d 893 (5th Cir. 1977).

126. The Preliminary Notes to both Rules 146 and 147, 17 C.F.R. 230.146-.147 (1977), provide that the following factors will be considered:

- (a) Whether the offerings are part of a single plan of financing;
- (b) Whether the offerings involve issuance of the same class of security;
- (c) Whether the offerings are made at or about the same time;
- (d) Whether the same type of consideration is to be received; and
- (e) Whether the offerings are made for the same general purpose.

It is submitted that a determination of whether the offerings in fact involve the same risk would be a more useful standard, though the SEC has not, to date, concurred.

127. Securities Exchange Act of 1934 § 15, 15 U.S.C. § 78o (1976). See also FLA. STAT. § 517.12 (1977).

128. SEC Release No. 33-4877, 32 Fed. Reg. 11,705 (1967).

129. SEC Release No. 34-10828, 39 Fed. Reg. 19,944 (1974).

business is entirely intrastate is lost forever by participation in any single offering in interstate commerce.

E. Rule 10b-5

The pervasive effect of rule 10b-5¹³⁰ will be of concern in workouts where the transaction is found to involve the purchase or sale of securities. In the case of a troubled entity, it is often easy, with hindsight, to find material omissions of fact which would have forecast problems if properly disclosed.

The Florida analog to rule 10b-5 is contained in section 517.301 of the Florida Statutes (1977). That section, however, is to remain in force only through July 1, 1980.¹³¹ In the meantime, it is important to note that a successful action under the Florida fraud provision does not require a showing of scienter. This is contrary to federal law.¹³²

F. Business in Distress: Creditors' Liability

Section 15 of the 1933 Act¹³³ and section 20 of the 1934 Act¹³⁴ extend potential liability for violations of the securities laws to "control persons." A control person is one who possesses the power to direct or cause the direction of management or policies.¹³⁵ Liability also attaches to aiders and abettors, and in this connection, the court in *Hochfelder v. Midwest Stock Exchange*¹³⁶ stated the basis for such liability as follows:

[W]e would not go so far as to charge a party with aiding and abetting who somehow unwittingly facilitated the wrongful acts of another. Rather, to invoke such a rule investors must show that the party charged with aiding and abetting had knowledge of or, but for a breach of duty of inquiry, should have had knowledge of the fraud, and that possessing such knowledge the party failed to act due to an improper motive or breach of a duty of disclosure.¹³⁷

There appears to be a developing trend of authority indicating that, under certain circumstances, liability may be asserted against

130. 17 C.F.R. § 240.10b-5 (1977).

131. See 1976 Fla. Laws, ch. 76-168, § 3(2)(w).

132. Compare *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976) with *Merrill Lynch, Pierce, Fenner & Smith v. Byrne*, 320 So. 2d 436 (Fla. 3d Dist. 1975).

133. 15 U.S.C. § 77o (1976).

134. 15 U.S.C. § 78t (1976).

135. *Rochez Bros., Inc. v. Rhoades*, 527 F.2d 880, 884 (3d Cir. 1975); *Ferland v. Orange Groves, Inc.*, 377 F. Supp. 690, 707 (M.D. Fla. 1974).

136. 503 F.2d 364 (7th Cir.), cert. denied, 419 U.S. 875 (1974).

137. *Id.* at 374.

a workout creditor as either a control person or as an aider and abettor. To date, the Fifth Circuit has not so held, though some convincing arguments have been made.¹³⁸ In *Woodward v. Metro Bank of Dallas*,¹³⁹ where the defendant bank was alleged to be liable as an aider and abettor in plaintiff's rule 10b-5 action, the court affirmed a dismissal of the complaint on the grounds that the defendant lacked an awareness of fraudulent activity and did not knowingly assist in its furtherance. On the other hand, in *Epprecht v. Delaware Valley Machinery, Inc.*,¹⁴⁰ the court denied a creditor's motion for summary judgment on a rule 10b-5 claim. The court stated that the creditors would be primarily liable if the plaintiff could prove that the creditors directly induced him to dispose of his interest by: (1) misrepresenting or failing to disclose a material fact; and (2) by doing so knowing that the truth had not been communicated or with reckless disregard for the truth.¹⁴¹ In addition, the court held that the plaintiff could hold the defendant-creditors secondarily liable as aiders and abettors if he could prove: (1) an underlying securities fraud by the primary violators; (2) sufficient knowledge of the fraud on the part of the creditors; and (3) that the creditors rendered substantial assistance to the primary violators in carrying out the securities fraud.¹⁴²

G. Exemptions through Reorganizations

The Securities Act of 1933 facilitates the issuance of securities in certain reorganizations. Section 3(a)(10)¹⁴³ exempts the following:

Any security which is issued in exchange for one or more bona fide outstanding securities, claims or property interests, or partly in such exchange and partly for cash, where the terms and conditions of such issuance and exchange are approved, after a hearing upon the fairness of such terms and conditions at which all persons to whom it is proposed to issue securities in such exchange shall have the right to appear, by any court, or by any official or agency of the United States, or by any State or Territorial banking or insurance commission or other governmental authority expressly authorized by law to grant such approval¹⁴⁴

138. See *Woodward v. Metro Bank of Dallas*, 522 F.2d 84, 97-100 (5th Cir. 1975); *Ferland v. Orange Groves, Inc.*, 377 F. Supp. 690, 708 (M.D. Fla. 1974). *But see Carroll v. First Nat'l Bank*, 413 F.2d 353 (7th Cir. 1969), *cert. denied*, 396 U.S. 1003 (1970).

139. 522 F.2d 84 (5th Cir. 1975).

140. 407 F. Supp. 315 (E.D. Pa. 1976). *See also Rochez Bros., Inc. v. Rhoades*, 527 F.2d 880, 886-89 (3d Cir. 1975).

141. 407 F. Supp. at 320.

142. *Id.* at 320, 322.

143. 15 U.S.C. § 77c(a)(10) (1976).

144. *Id.*

In 1935, the General Counsel of the Securities and Exchange Commission issued an interpretative release, elaborating upon the principal requirements for the availability of the exemption provided by section 3(a)(10).¹⁴⁵ That release, whose guidelines are still followed, provides that adequate notice of a hearing on the fairness of the issuance of securities proposed to be issued under the exemption provided by section 3(a)(10) must be given to all persons to whom it is proposed to issue such securities.¹⁴⁶ In order to conduct a fairness hearing which will suffice for section 3(a)(10) purposes, a state governmental authority (with the possible exception of a banking or insurance commission) must possess the express authority of law to approve the *fairness* of the terms and conditions of the issuance and exchange of the securities in question and to disapprove terms and conditions because they are unfair either to those who are to receive the securities or to other security holders of the issuer or to the public.¹⁴⁷ For purposes of the exemption provided by section 3(a)(10), a hearing by an authority *expressly* authorized by law to hold such a hearing is adequate even though applicable state law does not require such a hearing.

Section 3(a)(10) does not exempt resales by underwriters or control persons of the reorganized company from registration, nor does it exempt securities issued in a section 3(a)(10) transaction from the application of the anti-fraud provisions of section 10 of the Securities Exchange Act of 1934.¹⁴⁸

The practicalities of the implementation of the section 3(a)(10) exemption are complicated by its apparent application to the offer or sale of securities only after the requisite fairness hearing has been held. Offers to creditors prior to such a hearing might violate the registration requirements of the 1933 Act. Preliminary discussions held exclusively with a creditors' committee might be exempt as "preliminary negotiations," or as not constituting offers, since there is no participation by those to whom the securities would be distributed.¹⁴⁹

H. "Bona Fide" Reorganizations

Section 517.06(4) of the Florida Statutes (1977) provides an exemption from Florida registration for:

145. See Securities in Exchanges Approved by State Commissions, SEC Release No. 33-312 (March 15, 1935), 1 FED. SEC. L. REP. (CCH) ¶ 2181.

146. *Id.*

147. *Id.*

148. 15 U.S.C. § 78j (1976).

149. See generally Stutman, Francis, Corotto & Glatt, *Your Corporate Client is in Financial Difficulty and Solicits Your Advice*, 28 BUS. LAW. 253, 257-58 (1972).

[T]he issuance of securities to . . . equity security holders or other creditors of a corporation, trust, or partnership in the process of a bona fide reorganization of such corporation or entity made in good faith and not for the purpose of avoiding the provisions of this part, either in exchange for the securities of such equity security holders or claims of such creditors or partly for cash and partly in exchange for the securities or claims of such equity security holders or creditors

The Florida exemption is less formal than its counterpart in section 3(a)(10) of the Securities Act of 1933, and requires no "fairness" hearing. This provision, however, has been repealed, effective July 1, 1980,¹⁵⁰ and it remains to be seen how reorganizations will be treated subsequent to that date.

150. 1976 Fla. Laws, ch. 76-168, § 3(2)(w).