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## CORPORATIONS AND CORPORATE FINANCE

HUGH L. SOWARDS\*

### THE SEPARATE CORPORATE ENTITY

P was the sole owner of all the shares of stock in X corporation, whose assets consisted principally of intangible property. In 1959, X corporation filed an intangible property tax return which listed the intangibles owned by it at a stated value. X paid its 1959 intangible tax. For the same taxable year P filed his personal intangible tax return, but did not include for tax purposes the stock he owned in X corporation. In upholding the imposition of the tax with respect to P, the court refused to disregard the separate corporate entity.<sup>1</sup>

The case is one of first impression in Florida. Cases in other jurisdictions have split on the point.<sup>2</sup> In arguing that the court should disregard the corporate entity, P took the position that the "double" imposition of the tax would contravene Florida constitutional and statutory provisions prohibiting an intangible tax rate in excess of two mills.<sup>3</sup> The court's refusal to consider P, the sole stockholder in X corporation, as the owner of the property of X corporation, was based partially upon the reasoning that "the value of appellant's corporate stock . . . bears no necessary relationship to the value of the intangible property owned by the corporation itself. The value of corporate intangibles may be substantial, but because of the manner in which the corporation conducts its affairs its liabilities might possibly exceed its assets to such an extent as to render it insolvent."<sup>4</sup> The case is in line with the modern trend of authority to the effect that, *under certain circumstances* the corporation is regarded as having a personality all of its own as a fictitious person, and that taxation presents one of these circumstances.

In another case<sup>5</sup> dealing with the nature of the corporate entity, a corporation was wholly owned by a husband and wife, parties to a divorce action. Had the chancellor awarded the wife her separate corporate interest, she would have become a minority stockholder in a hostile situation. Ac-

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1. Marks v. Green, 122 So.2d 491 (Fla. App. 1960).

2. Accord, Klein v. Board of Tax Supervisors, 282 U.S. 19 (1930); People v. Commissioners, 71 U.S. (4 Wall.) 244 (1866); Commissioner v. Moline Properties, Inc., 131 F.2d 388 (5th Cir. 1942); *contra*, Inhabitants of E. Livermore v. Livermore Falls Trust & Banking Co., 103 Me. 418, 69 Atl. 306 (1907).

3. FLA. CONST. art. IX, § 1; Fla. Laws 1957, ch. 57-399, § 1(2), at 920 (now FLA. STAT. § 199.11(2) (1961)).

4. Marks v. Green, 122 So.2d 491, 493 (Fla. App. 1960).

5. Turk v. Turk, 118 So.2d 67 (Fla. App. 1960).

cordingly, the chancellor ordered liquidation of the wife's interest in the corporation by requiring the husband to purchase that interest. The liquidation and purchase were effected by disregarding the corporate entity and requiring the corporation to sign a secured note which the husband was directed to give to his wife for the purchase price of her stock. The chancellor's action was upheld on appeal.<sup>6</sup>

### SHAREHOLDERS' RIGHTS

#### *Voting — Outsiders*

*P* corporation made an offer to merge with *D* corporation, an insurance company. *D* corporation then solicited proxies favoring the proposed merger. Prior to the shareholders' meeting, however, the insurance commissioner placed certain qualifications on *D* corporation's continuance in business. At the shareholders' meeting the proxies were voted for the merger; however, the proposal now included the insurance commissioner's qualifications. These qualifications were conditions precedent imposed on the *P* corporation and had to be performed before *D* corporation was bound by the agreement. *P* corporation never complied with these conditions. Subsequently, *C* corporation made an offer to purchase the business of *D* corporation; this offer was accepted. *P* corporation then brought an action for specific performance, alleging that the proxies were improperly voted at the shareholders' meeting of *D* corporation, because the proposal contained qualifications not present when the proxies were solicited.<sup>7</sup>

In granting judgment for *D* corporation, the court adhered to the well recognized principle that third persons cannot complain of corporate action taken at a stockholders' meeting, on the ground of irregularities or other formal defects in the meeting, at least when this action affects only the conduct of the corporation within the scope of its charter powers.<sup>8</sup> In the instant case the plaintiff was not in privity with any of the shareholders of *D* corporation and therefore had no standing to complain of the manner in which the proxies were voted; the proper parties to complain were the stockholders who gave the proxies.

#### *Pre-emptive Rights*

The corporate code grants pre-emptive rights to shareholders unless those rights are expressly denied by the certificate of incorporation.<sup>9</sup> However, the issuance of shares to which the rights attach must be "for cash."

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6. See also *Kay v. Key West Dev. Co.*, 72 So.2d 786 (1954); 1 FLETCHER, PRIVATE CORPORATIONS § 46 (rev. perm. ed. 1931).

7. *Abbey Properties Co. v. Presidential Ins. Co.*, 119 So.2d 74 (Fla. App. 1960).

8. See Annot., 51 A.L.R. 941 (1927).

9. FLA. STAT. § 608.42(2) (1961).

In *Curtis v. Briscoe*,<sup>10</sup> stock was issued in consideration for services to be rendered. The court properly held that complaining shareholders were not entitled to pre-emptive rights. It should be pointed out, however, that apart from the doctrine of pre-emptive rights, even a non-cash issuance of shares is subject to cancellation in equity if tainted with fraud.<sup>11</sup> In the instant case the court indicated its awareness of this equitable relief by granting the plaintiff time within which to file an amended complaint clearly alleging fraudulent activity.

#### LIABILITIES AND LOYALTIES OF CORPORATE OFFICIALS

Corporate officials occupy a fiduciary relationship toward their corporations. Is there a similar fiduciary relationship between corporate officials and *individual shareholders*? Authorities are in conflict on this point. The older view answered the question in the negative, in the absence of deliberate active deception on the part of the corporate official. This answer proceeded from the premise that individual rather than corporate business was involved. Thus, the corporate official could trade freely at arms length with individual shareholders. Newer cases, however, have viewed the situation in a more realistic light. In short, the corporate official must disclose all material facts to the prospective shareholder-seller or purchaser of shares. Added impetus to this newer doctrine has been given by Rule 10b-5<sup>12</sup> of the Securities Exchange Act of 1934.<sup>13</sup> This rule is applicable when any person engages in fraudulent practices, makes misstatements or *fails to tell the whole truth* in connection with the purchase and sale of securities.<sup>14</sup>

In view of this trend, the result in the recent case of *Rogers v. Riddle*<sup>15</sup> is somewhat surprising. R, the president, director and general manager of Riddle Airlines, possessed knowledge as an insider that a wealthy investor was on the point of buying into the company. After conference with this investor, Riddle called other shareholders and bought their shares without disclosing his inside information. The court refused to grant rescission of the sales based upon the chancellor's findings of insufficient evidence to establish fraud. There was a strong dissenting opinion, on the ground that the majority's holding was contrary to the manifest weight of the evidence. "What was proved was ample for rescission."<sup>16</sup>

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10. 129 So.2d 450 (Fla. App. 1961).

11. See *Rowland v. Times Pub. Co.*, 160 Fla. 465, 35 So.2d 399 (1948).

12. 17 C.F.R. § 240.10b-5 (1949).

13. 48 Stat. 881 (1934), 15 U.S.C. § 78 (1958).

14. The rule is applicable only when the mails or facilities of interstate commerce are used to effect the transaction. For an innovation on the application of the rule see in the matter of *Cady, Roberts & Co.*, Securities Exchange Act Rel. No. 6668 (Nov. 8, 1961).

15. 128 So.2d 409 (Fla. App. 1961).

16. *Id.* at 414. See also *Reed v. Riddle Airlines*, 266 F.2d 314 (5th Cir. 1959) which involved a similar transaction. The court stated that the president and general manager of the company owed a fiduciary duty to a stockholder from whom he had

With respect to liabilities of corporate officials, the corporate code imposes personal liability if those officials transfer any corporate property when the corporation is insolvent, with the intent of giving a preference to any particular creditor over other creditors of the corporation.<sup>17</sup> In a recent case,<sup>18</sup> the president and controlling shareholder of a corporation used corporate funds for the benefit of another corporation in which he had an interest, receiving in return a conveyance of land to himself. The secretary of the corporation signed documents necessary to effect the transaction. This activity took place at a time when the corporation could not meet its current obligations.

In holding the president personally liable, the court first took the position that "insolvency" as used in section 608.55<sup>19</sup> of the Florida Statutes means a general inability to answer in the course of business the liabilities existing and capable of being enforced, rather than an excess of liabilities over assets.<sup>20</sup> Once this test of insolvency was adopted, the president's conduct obviously fell within the statutory prohibition and was "with the intent of giving a preference."<sup>21</sup> Inasmuch as there was no showing that the secretary knew that the transfer was a preference or participated in it except by signing as secretary at the president's direction, no personal liability was imposed on him.

#### TRANSFER OF SHARES

In a well reasoned opinion<sup>22</sup> involving the Uniform Stock Transfer Law,<sup>23</sup> the court was called upon to distinguish between rights accruing to innocent purchasers and those as between transferor and transferee. *P* paid *D* 15,000 dollars for *R* corporation stock. *D* assigned this stock to *P* by a separate instrument and gave *P* a power of attorney to transfer it. At this time *D* had not yet received his stock certificates, but had a letter from *R* corporation advising him that the shares were set aside for him on *R*'s books and records. Subsequently, dividends were declared by *R* corporation on four separate occasions; *D* paid these dividends to *P*. Still later, *R* corporation went into reorganization under chapter X of the Bankruptcy Act.<sup>24</sup> *P* then brought an unsuccessful action to cancel the sale.

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purchased stock of the company, to disclose to the latter the knowledge he had as an insider which would affect the value of the stock.

17. FLA. STAT. § 608.55 (1961).

18. *Williams v. American Crafts, Inc.*, 129 So.2d 165 (Fla. App. 1961). See also *Levine v. Johnson*, 287 F.2d 623 (5th Cir. 1961).

19. FLA. STAT. § 608.55 (1961).

20. See also *Brown Packing Co. v. Lewis*, 185 Misc. 445, 58 N.Y.S.2d 443 (Sup. Ct. 1943); *Rett, When is a Corporation Insolvent?*, 30 MICH. L. REV. 1040 (1932).

21. FLA. STAT. § 608.55 (1961).

22. *Smallwood v. Moretti*, 128 So.2d 628 (Fla. App. 1961).

23. FLA. STAT. ch. 614 (1961).

24. 52 Stat. 833 (1938), as amended, 11 U.S.C. §§ 501-676 (1958).

Section 614.03(1)<sup>25</sup> of the Florida Statutes permits the transfer of stock certificates only if there is *delivery* of the certificates. Furthermore, an opinion of the Attorney General<sup>26</sup> stated that the Uniform Stock Transfer Law contemplates delivery of stock certificates as essential to the transfer of legal title to corporate stock. But the court observed that the section in question and the Attorney General's opinion were concerned with the protection of innocent purchasers, creditors and others similarly situated, rather than with the rights between regular transferors and transferees. The latter situation, the court pointed out, is governed by another section of the statute which provides that attempted transfers of title to stock certificates without delivery "shall have the effect of a promise to transfer and the obligation, if any, imposed by such promise shall be determined by the law governing the formation and performance of contracts."<sup>27</sup> Stated another way, an attempted transfer, such as the one in the instant case, causes the equitable title to pass to the transferee with an implied promise to transfer legal title to him, enforceable in accordance with the law of contracts. The decision is in accord with those in other jurisdictions.<sup>28</sup>

In *Young v. Edwards*,<sup>29</sup> Y brought an action for specific performance of a first refusal agreement to purchase corporate stock. The agreement provided that in the event E at any time within five years "decides to sell his Class B stock . . . [Y] shall have the first refusal to buy such stock, paying therefor an amount equal to any bona fide offer to purchase which . . . [E] may have received . . . ."<sup>30</sup>

While this agreement was in effect, E entered into an option contract with B, under which B had an option, commencing after expiration of the E-Y agreement to buy E's stock at one dollar per share. The option contract contained other conditions. In granting judgment for E, the court reasoned that E's option grant was not unconditional and therefore not a "decision to sell" on E's part which would have activated Y's first refusal privilege. The court was careful to point out that "if . . . [E] has made an unconditional offer to . . . [B] to sell . . . doubtless . . . [Y's] rights of first refusal would have been activated . . . ."<sup>31</sup>

#### DISSOLUTION AND LIQUIDATION

Does corporate dissolution necessarily call for a sale of the corporate assets? Section 608.29(4)<sup>32</sup> of the Florida Statutes provides that in the event of dissolution final distribution of assets shall be made "in such man-

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25. FLA. STAT. § 614.03(1) (1961).

26. [1959-1960] FLA. ATT'Y GEN. BIENNIAL REP. 579, 581.

27. FLA. STAT. § 614.12 (1961).

28. See cases cited 6 UNIFORM LAWS ANNOTATED § 10 (1922, Supp. 1961).

29. 122 So.2d 211 (Fla. App. 1960).

30. *Id.* at 212.

31. *Id.* at 215.

32. FLA. STAT. § 608.29(4) (1961).

ner as the court may determine . . .” In *Blanchard v. Commonwealth Oil Co.*,<sup>33</sup> C corporation was dissolved by operation of law for failure to pay capital stock taxes. There were no creditors. C corporation’s assets, consisting of a fractional interest in a mineral base contract and an oil exploration contract, were divisible and distributable in kind. Over the objection of minority shareholders, the chancellor ordered a sale of the corporate assets at public auction. This method of liquidation resulted in a distribution in cash rather than in kind. Furthermore, this sale placed the minority shareholders in the unenviable position of being forced either to buy out the majority, or accept the value set by the majority.

The court correctly held that inasmuch as there were no corporate creditors and no necessity for a sale at public auction, the assets should have been distributed in kind among the stockholders according to their respective interests. The point is that section 608.29(4)<sup>34</sup> of the Florida Statutes conferring power on the court to order final distribution of assets “within . . . such manner as the court may determine,” does not give the court an unbridled discretion. Rather, this discretion “must be exercised with due regard to the nature of the assets, the circumstances of the parties and the effect on the rights and interests of the distributees.”<sup>35</sup>

#### LEGISLATIVE CHANGES

##### *Corporate Code*

A significant amendment to the corporate code provides for the reservation of a corporate name for a proposed corporation.<sup>36</sup> Prior to this amendment, corporate names were granted on a “first-come, first-served” basis. The attorney who had obtained clearance for the use of a name with the Secretary of State had no assurance that this name would not be legally appropriated prior to completion of his incorporation. In certain other states, however, where the governing statutes permit the reservation of corporate names for an unlimited period of time, the practice of reserving numerous names with the hope of selling them created an untenable situation. In enacting the amendment in question, the Florida Legislature wisely limited the reservation period to fifteen days plus an additional fifteen day renewal period in the discretion of the Secretary of State.

##### *Florida Securities Act*

The Florida Securities Act<sup>37</sup> provides for certain exempt securities which

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33. 116 So.2d 663 (Fla. App. 1959).

34. FLA. STAT. § 608.29(4) (1961).

35. *Blanchard v. Commonwealth Oil Co.*, 116 So.2d 663, 669 (Fla. App. 1959).

36. FLA. STAT. § 608.031 (1961).

37. FLA. STAT. ch. 517 (1961).

may be sold without registration.<sup>38</sup> One long-time exempted security was short-term paper, such as negotiable promissory notes maturing in not more than twelve months from the date of issue. But in the late 1950's, as securities prices advanced and the public came into the market on a gigantic scale, the practice grew on the part of unscrupulous persons of offering a fifteen per cent return on short-term paper, often "secured" by a lien on worthless or near-worthless realty or personal property. Of course, in order to pay a fifteen per cent return, the issuer of this paper would have to earn as high as twenty-five per cent on the invested funds. Needless to say, the perpetrators of these schemes frequently folded their tents and crept away, leaving the "investor" holding the bag. In 1959, a much needed amendment<sup>39</sup> to section 517.05(9) of the Florida Statutes exempted short-term paper only if the maximum yield did not exceed eight per cent and the paper was not secured by a lien on real or tangible personal property. Ostensibly this amendment cured the mischief previously discussed. Therefore it is difficult to understand why the Florida Legislature, at its 1961 session, repealed this section, thus eliminating short-term paper altogether from the list of exempt securities.<sup>40</sup> It is submitted that this action may unduly hamper legitimate business enterprises in their efforts to obtain public funds.

Even if the security in question is not exempt from the registration provisions of the act, the *transaction* in which that security is sold may be exempt. By way of illustration, section 517.06(5)<sup>41</sup> of the Florida Statutes exempts sales to certain classes of sophisticated investors such as banks, insurance companies, and securities brokers and dealers. However, trusts and pension plans were not included. A 1961 amendment to this section<sup>42</sup> now includes sales to these investors as exempt transactions.

An additional exempt transaction under the act concerned bonds or notes secured by mortgages upon real estate or tangible personal property when the entire mortgage, together with all of the bonds or notes secured thereby, were sold to a single purchaser at a single sale.<sup>43</sup> Recently, however, dangerous practices arose with respect to "guarantees" and "insurance" features concerning the issuance of these securities. A 1961 amendment<sup>44</sup> provides that bonds or notes cannot be sold in an exempt transaction if they contain an express recourse agreement or guarantee as to repayment

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38. FLA. STAT. § 517.05 (1961).

39. Fla. Laws 1959, ch. 59-256, § 1, at 905.

40. Fla. Laws 1961, ch. 61-78. Also at its 1961 session, the Florida Legislature enlarged the exemption for securities of agricultural cooperatives by exempting sales of such securities if the cooperative in question operates wholly within the borders of Florida (formerly, a "single county") and if all of its stockholders are Florida residents (formerly, "residents of such county"). Fla. Laws 1961, ch. 61-103 (FLA. STAT. § 517.05(10) (1961)).

41. FLA. STAT. § 517.06(5) (1961).

42. Fla. Laws 1961, ch. 61-405.

43. FLA. STAT. § 517.06(7) (1961).

44. Fla. Laws 1961, ch. 61-455.



of principal or interest. In addition, bonds or notes are exempt "if they are fully insured by an insurance company authorized to do business in this state under chapter 635, Florida Statutes, or insured or guaranteed by an agency of the federal government."<sup>45</sup>

The Florida Securities Act<sup>46</sup> regulates not only the sale of securities, but those persons who sell them — brokers and dealers. A 1961 amendment<sup>47</sup> now makes it clear that one who holds both a security dealer's license and a life insurance license is subject to the act when he offers to prospective purchasers a life insurance "investment plan" such as a mutual fund program. The new amendment provides for revocation of his security dealer's or salesman's license unless he prepares and leaves with each prospective buyer a written and signed proposal, on or before delivery of any investment plan.

#### *Professional Service Corporation Act*

At its 1961 session, the Florida Legislature authorized the creation of professional service corporations, providing for the incorporation of an individual or group of individuals to render the same type of professional services to the public as are now rendered by unincorporated persons or groups.<sup>48</sup> These professional services include those of attorneys, accountants, doctors, dentists, chiroprodists, podiatrists, architects, veterinarians and life insurance agents. This new piece of legislation is the subject of detailed treatment in a recent article in the *University of Miami Law Review*.<sup>49</sup>

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45. *Ibid.*

46. FLA. STAT. ch. 517 (1961).

47. Fla. Laws 1961, ch. 61-448 (FLA. STAT. § 517.16(10)(a) (1961)).

48. FLA. STAT. ch. 621 (1961). See also, In the Matter of the Florida Bar, 133 So.2d 554 (1961).

49. Buchmann & Bearden, *The Professional Service Corporation—A New Business Entity*, 16 U. MIAMI L. REV. 1 (1961).