

University of Miami Law Review

Volume 12
Number 3
Volume 12 Issues 3-4
Third Survey of Florida Law

Article 8

7-1-1958

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Recommended Citation

Hugh L. Sowards, *Corporations and Corporate Finance*, 12 U. Miami L. Rev. 418 (1958)
Available at: <https://repository.law.miami.edu/umlr/vol12/iss3/8>

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CORPORATIONS AND CORPORATE FINANCE

HUGH L. SOWARDS*

I

THE SEPARATE CORPORATE ENTITY PRIVILEGE

A number of cases during the past two years involved situations wherein creditors, attempting to collect their claims from the corporate treasury, found it empty and then sought to hold the shareholders individually liable. In each instance, of course, the court was urged to "pierce the corporate veil." Such urging was no doubt given added impetus by the holding in a recent North Carolina case which has attracted national attention.¹ That decision squarely held that in order for a corporation to have legal existence there must be a minimum of three shareholders at all times. From the governing statutory provision² prescribing "three or more" incorporators, the Supreme Court of North Carolina drew the conclusion that when less than three persons acquire all the shares, the corporation becomes "dormant" and can no longer act as a corporation. Thus creditors and other plaintiffs may disregard the corporate entity and hold shareholders individually liable in all one-man and two-man corporate situations. Although the corresponding section of the Florida corporate code is very similar³ to that of North Carolina, the Supreme Court of Florida has consistently adhered to the well recognized doctrine that the separate corporate entity privilege will not be disregarded unless that privilege has been abused. Such abuse may exist when the privilege is employed for illegal, fraudulent or unfair purposes, but the fact that the corporation is organized for the avowed purpose of escaping personal liability does not of itself spell abuse of the privilege.⁴

In *Advertects, Inc. v. Sawyer Industries*,⁵ a husband and wife had organized a corporation as a convenient method of doing business and admittedly for the purpose of limiting their liability. The plaintiff, a creditor, recovered a money judgment against the corporation, but this judgment was returned unsatisfied because of a lack of sufficient assets in the corporate treasury. He then sought to hold the defendant shareholders liable individually. In refusing to "pierce the corporate veil", the court was careful to

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1. *Park Terrace, Inc. v. Phoenix Indemnity Co.*, 241 N.C. 473, 85 S.E.2d 677 (1955); *rehearing*, 243 N.C. 595, 91 S.E.2d 586 (1956).

2. N.C. GEN. STAT. § 55-8 (1955). The statute has now been amended to provide that limited liability is not lost "even if all the shares are owned by one person." N.C. GEN. STAT. §§ 55-53 (c) (1955).

3. FLA. STAT. § 608.03 (1955).

4. *Advertects Inc. v. Sawyer Industries*, 84 So.2d 21 (Fla. 1955).

5. *Ibid.*

point out that there had been no fraud or improper conduct, either in the organization or operation of the corporate enterprise. The reasoning then proceeded on the basis that to disregard the corporate entity in every case in which a limited number of shareholders owned all of the stock would be tantamount to destroying the corporate entity as a method of doing business. "The corporate veil will not be penetrated either at law or in equity unless it is shown that the corporation was organized or employed to mislead creditors or to work a fraud upon them."⁶ The case is consistent with previous holdings.⁷

But, in *Codomo v. Emanuel*,⁸ wherein defendant, a principal shareholder, permitted her own funds to be mingled and confused with those of the corporation, and where the corporation kept no minutes, held no meetings and employed questionable bookkeeping methods, the court did brush aside the corporate entity and fastened individual liability upon the defendant. The case is well reasoned and at the same time easily reconciled with the *Sawyer* decision⁹ on the basis that in the instant case the co-mingling of funds and assets, together with the general manner of corporate operation rendered the corporation little more than defendant's "corporate pocket." The court went even further, however, in holding that defendant, in permitting the use of her funds in corporate transactions and manipulations "must have known what was going on . . . and she participated in a fraud upon creditors."¹⁰

In another case dealing with the nature of the corporate entity,¹¹ Corporation A, all of whose shares were owned by P, executed a note payable to Corporation B. Corporation A sought to have this note declared null and void on two grounds: (1) that the loan made in form to Corporation A was actually a loan to P as an individual which would make the loan usurious; (2) that the repeal of the statute prohibiting a corporation from pleading usury as a defense¹² made the current usury statutes¹³ applicable to the loan notwithstanding that the loan was made before the repeal of the prior statute. With respect to the first ground, the court took the position that although the corporation was organized for the sole purpose of taking the loan and avoiding the usury laws, such activity did not constitute an abuse of the corporate entity privilege.¹⁴ With respect to the second point, the

6. *Id.* at 23.

7. See e.g. *Gross v. Cohen*, 80 So.2d 360 (Fla. 1955); *Scheiner v. Adamco*, 81 So.2d 205 (Fla. 1955).

8. 91 So.2d.653 (Fla. 1956) (Noted in 12 MIAMI L.REV. 122 (1957)).

9. See note 4 *supra*.

10. 91 So.2d at 655 (Fla. 1956).

11. *Holland v. Gross*, 89 So.2d 255 (Fla. 1956).

12. FLA.STAT. § 612.62 (1947).

13. FLA. STAT. § 687.07 (1953).

14. "The mere fact that the sole owner of the corporate stock is an individual is alone not enough to indicate that the loan was made to the individual so as to make available to the corporation the usury defense." *Holland v. Gross*, 89 So.2d 255, 257 (Fla. 1956).

court held that since the loan was made at a time when a corporation could not plead usury as a defense, the note, even if made to Corporation A rather than to P, was therefore valid and enforceable at the time of execution. Subsequent repeal of the statute now means that a corporation *can* plead usury as a defense,¹⁵ but such repeal came at too late a date to aid the plaintiff.

II

LIABILITIES AND POWERS OF OFFICERS AND DIRECTORS

If directors of a corporation do not direct, they may be held personally liable to shareholders. One such instance occurs when directors abuse their fiduciary relationship by effecting preferential transfers of corporate assets. In *Porterfield v. Marden*,¹⁶ two shareholders of a bankrupt corporation attempted to fasten personal liability upon the directors. The court conceded that a stockholder may bring an action against directors when fraud has been perpetrated either upon the corporation or upon the stockholders. But in the instant case the court found no evidence to the effect that the corporate bankruptcy was caused by preferential transfers on the part of the directors or that there had been any seclusion of the corporate assets or other fraud. In the absence of such a showing, the court reasoned that to allow such a shareholders' suit to succeed would, in effect, be permitting the shareholders in question to protect themselves by a judgment against the directors to the exclusion of corporate creditors.

In *Dickson v. Graham-Jones Paper Co.*,¹⁷ a question of vicarious corporate liability for acts of a corporate agent was presented. The defendant corporation was unsuccessfully sued by a business invitee who was attacked by a "fighting cock" which defendant's branch manager permitted to be kept in the branch office. The complaint failed to allege either that the defendant corporation had knowledge of the keeping of the animal or that such keeping was within the scope of the manager's authority. Of course, it is fundamental that a corporation is only responsible for the acts of its agents while acting within the scope of their authority or in furtherance of corporate business. Since the corporation in question was in the paper business, it was inconceivable to the court how the keeping of such an animal was in furtherance of corporate business. Furthermore, it is the general rule that knowledge acquired or possessed by an agent of a corporation otherwise than in the course of his employment is not notice to the corporation.¹⁸ Since neither the authority nor knowledge factors were even alleged in the pleadings, the court's holding is certainly justifiable.

15. See *Sodi Inc. vs. Salitan*, 68 So.2d (Fla. 1953).

16. 88 So.2d 608 (Fla. 1956).

17. 84 So.2d 309 (Fla. 1955).

18. See 3 *Fletcher, Corporations* 793 (1938).

Another case¹⁹ involving authority of corporate officers and agents was also decided along well established lines of precedent. Specifically, the case involved the authority of a vice-president to bind his corporation. The vice-president had written a letter purporting to ratify a contract; he signed this letter as vice-president of the corporation. No showing whatever was made that he was in any way authorized to bind the corporation or that any action was taken by third parties in reliance upon his signature or, finally, that any benefit accrued to the corporation as a result of his action. In granting judgment for the defendant the court followed the firmly recognized principle that the vice-president of a corporation has no authority to bind it merely by virtue of his office; he may bind the corporation only if his action is within the scope of his authority.²⁰

III

RECEIVERS

The appointment of a receiver is in the nature of extraordinary relief. Florida courts in past decisions have refused to grant this relief except when there has been an affirmative showing of fraud, gross mismanagement or insolvency.²¹ Recent cases are no exception. Two such requests for appointment of a receiver failed in the absence of a showing of any fraud or mismanagement. In the first of these cases²² the plaintiff owned only one-sixth of the corporation's issued and outstanding shares. Not only was no fraud or mismanagement shown, but the corporation in question was a solvent and going concern. In the second case²³ plaintiff failed even to establish any interest on his part in the business. In neither case, then, was there any compelling reason for the appointment of a receiver.

IV

DISSOLUTION

Upon dissolution for nonpayment of taxes the corporate life is not ended; it continues after dissolution for the purpose of "satisfying its liabilities, selling and conveying its property and dividing the net remaining assets among the stockholders . . ." ²⁴ What is the status of its assets, after dissolution, if no action whatever is taken by its directors in accord with the above statutory provision? The answer to this interesting question appears in

19. *Pan-American Construction Co. v. Searcy*, 84 So.2d 540 (Fla. 1956).

20. "The vice-president of a corporation, in the ordinary case, does not possess the inherent powers of the president unless he is acting in the president's absence, disability or death. *Id.* at 544.

21. See *McAllister Hotel v. Schatzberg*, 40 So.2d 201 (Fla. 1949); *Papazian v. Kulanjian*, 78 So.2d 85 (Fla. 1955).

22. *Jones v. Harvey*, 82 So.2d 371 (Fla. 1955).

23. *Applebaum v. Appel*, 82 So.2d 738 (1955).

24. FLA. STAT. § 608.30 (1) (Fla. 1957).

Trueman Fertilizer Co. v. Allison.²⁵ Deceased died intestate in 1930 owing plaintiff corporation a debt evidenced by promissory notes. Among the assets of deceased's estate was nearly all the capital stock of a real estate corporation. An administrator was appointed, but the estate was not administered. No distribution of the assets of the corporation or of the stock owned by the estate was made. In 1936 this corporation was dissolved for failure to pay the corporation stock tax, and the taxes then due on the real estate which resulted in the issuance and sale of tax certificates in 1939. In 1941, plaintiff corporation purchased these tax certificates for the purpose of protecting its claim. In 1950 plaintiff corporation reduced its notes to judgment; it sought in the instant case to foreclose a lien arising from the redemption of the tax sales certificates. In holding for the plaintiff, the court pointed out that under the governing statute,²⁶ when the corporation was dissolved for non-payment of the capital stock tax, the beneficial title to its assets was vested in the shareholders with legal title in the directors as trustees. It thus became the duty of the directors to pay the real estate taxes and in case of their failure to do so, the responsibility was that of the shareholders.²⁷ The opinion went on to state that as long as the plaintiff's claim was unsatisfied, the passage of time did not affect it.²⁸ Plaintiff had such an interest in the realty of the dissolved corporation as would entitle it to redeem the tax certificates and not be classed as a mere volunteer.

VI

LEGISLATIVE CHANGES

At the 1957 session of the Florida Legislature a few amendments to the corporate code were enacted.

From the standpoint of drafting the corporate charter, attorneys will be interested to learn that it will no longer be necessary to include the names of the first officers of the corporation in the application for the charter.²⁹

25. 81 So.2d 734 (Fla. 1955).

26. FLA. STAT. § 610.18 (1953). The present relevant section, similarly worded, is section 608.30 (6) (1955).

27. "Thus the beneficial interest as such was not vested in the heirs-at-law of decedent as would be real estate owned by decedent at death." See note 25 *supra* at 737.

28. Section 608.30 (6) now provides that "The trustees shall continue as trustees of the property of such dissolved corporation. . . . in no event for a longer term than thirty years from the date of dissolution or expiration."

29. FLA. STAT. § 608.03 (h) (1957). Attention is also called to amendment of section 608.03 (2) (i). Prior to this amendment the sum of values of the consideration of subscribers' stock could not be less than the amount of capital with which the corporation began business. This requirement has now been eliminated. With regard to the former requirement of including the names of officers of the proposed corporation, one wonders, from the standpoint of corporate procedure, how *officers* could be named before having been elected by the board of directors, which election occurs *after* approval of the charter by the Secretary of State! (Such a requirement was not present prior to 1953).

A new method for amendment of the corporate charter has been added.³⁰ If all the directors and all the shareholders of a corporation sign a written statement indicating their intention to amend the certificate of incorporation, such a statement may be filed with the Secretary of State as effectively as if any of the other and more formal methods of amendment were employed.

Another amendment,³¹ in repealing section 47.17 relating to an alternative method of service of process on private corporations, provides that whenever any corporation, domestic or foreign, fails to properly designate a place for service of process³² or an agent upon whom process may be served, then process directed to a domestic corporation may be served upon any officer or agent of such domestic corporation resident in the State of Florida or transacting business for it in the state. Process directed to any foreign corporation failing to comply with the service of process statutes may be served upon any agent of such foreign corporation transacting business for it in Florida.

Two other statutory changes relate to non-profit corporations. The first of these changes³³ concerns authorization of a profit corporation to convert to a non-profit corporation upon certain additional requirements being fulfilled. The second change³⁴ enlarged the exemption for solicitation by charitable organizations by adding duly licensed child welfare agencies to the list of exempted organizations.

Prior to 1949 a section of the Florida Statutes³⁵ provided that any corporation failing to pay the capital stock tax more than six months after the due date forfeited its corporate charter until such tax was paid. This section was repealed and is now replaced by another section,³⁶ but doubt persisted concerning the validity of real property instruments executed by corporations, not dissolved or expired, but delinquent more than six months as to payment of the tax, at the time of executing such instruments. Accordingly, a new section³⁷ now provides that all real property instruments executed by such a delinquent corporation are valid.³⁸

30. FLA. STAT. § 608.18 (1957).

31. FLA. STAT. § 47.17 (1957).

32. As provided in § 47.34-47.36 (1957).

33. FLA. STAT. § 617.16. Section 617.20, providing that the right to change the corporate status from profit to non-profit would expire in 1947, was also repealed.

34. FLA. STAT. § 617.22 (1957).

35. FLA. STAT. § 610.11 (1943).

36. FLA. STAT. § 608.35 (1957).

37. FLA. SESSIONS LAWS, 57.264 (1957).

38. Remaining statutory changes concern specific industries. Section 608.60 (cementary companies) was amended to enlarge and make specific the supervision and authority of the state comptroller, and to provide for regulatory license and examination fees. Section 625.02 (insurance companies) changes the amount and par value of capital stock and surplus of insurance and surety companies. Section 626.05 (foreign insurers) changes requirements for qualification of foreign insurers from the standpoint of a period of time of successful operations. Section 626.25, relating to voluntary deposits by fire, casualty and title insurers, now specifies certain securities eligible for such deposits. Section 626.29

CORPORATE FINANCE

Blue Sky Legislation

The new statutory provision for examination of brokers, dealers and investment advisers³⁹ represents one of the greatest steps forward in recent years from the standpoint of investor protection. Prior to this important amendment, the obtaining of a security dealer's license was a much too simple proposition. The result was that numerous persons totally unqualified and sometimes unscrupulous, became security dealers. The legitimate investment fraternity in Florida, as well as attorneys, will welcome this new piece of legislation.

Whether the amendment is the final answer to screening of applicants who seek to handle "other people's money," however, is open to question. It should be noted first, that the examination provision is put on a "may also require" basis.⁴⁰ It is to be hoped that the Florida Securities Commission will turn this "may" into a "must." Because of this discretionary feature the amendment has been criticized as a "watered down" protection for the public investor.⁴¹

Of no less importance to investor protection is a new criminal penalty provision subjecting to heavy fine and/or imprisonment any person who gives false or fraudulent information in any matter within the jurisdiction of the Florida Securities Commission.⁴² The important point in this connection is that prior to offering securities for public sale, the issuer normally must file an application with the Florida Securities Commission.⁴³ The application forms call for detailed financial and other pertinent information about the company as well as the background of its officers and directors. Instances have been numerous where applicants have been lax, have tended to gloss over the answers contained in the forms as well as the data included in the prospectus, which must be made available to a purchaser of securities at or before the time of sale.

Aside from the previously discussed amendment concerning discretionary examination of brokers, dealers and investment advisers, no part of the pro-

amends the law with respect to the printing, sale and distribution of insurance books and pamphlets by the insurance commissioner. Section 631.17 (1) was amended to prohibit fire, casualty and surety companies from exposing themselves to loss from any one risk in an amount exceeding ten per-cent of the company's surplus to policyholders. The above changes also involved the repeal of Section 626.06.

39. FLA. STAT. § 517.12 (1957).

40. "... the Commission may also require applicants to be licensed as a dealer or as a salesman to submit to and pass successfully oral or written examination to determine the applicant's qualifications and competency to engage in the business of dealing in and selling securities as a dealer or as a salesman."

41. Harum, *Need for Reform in Security Dealer Legislation*, 12 Miami L.Rev. 75 (1957).

42. FLA. STAT. § 517.31 (1957).

43. FLA. STAT. c. 517 (1957). There are certain public offerings which are exempt from registration with the commission. See Fla. Stat §517.05(1957).

posed Uniform Securities Act was adopted. Professor Louis Loss of the Harvard Law School had drafted this proposed legislation. At one time it appeared to be headed for enactment in Florida. After almost unanimous approval by the National Association of Securities Dealers and the Florida Security Dealers Association,⁴⁴ support seemed to fade away. The present survey article is no place for a discussion of Professor Loss' proposed Uniform Act.⁴⁵ Suffice it to say here that it is the individual view of the writer that the proposed act is sound and workable from beginning to end. It is to be hoped that the next legislature will see fit to give serious consideration to its adoption *in toto*.

Administrative Developments

Several recent policy releases by the Florida Securities Commission merit the careful attention of attorneys engaged in the processing of applications for public securities offerings.

Every advertisement used in connection with a public offering of securities in Florida must now be authorized by the commission before being placed or used in newspapers or similar modes of communication.⁴⁶

The commission has taken the position that it will look with disfavor upon new corporations issuing interest bearing obligations or preferred stock, "except in rare cases which are justified by a reasonable excess of assets over liabilities to the extent of meeting principal requirements."⁴⁷ In short, the apparent import of this release is that, as a general rule, the new corporation will be wise to offer common stock rather than bonds or preferred shares to the public.

With respect to cooperative housing ventures there has existed much confusion among attorneys as to whether registration with the commission is necessary. The answer, of course, is that if the cooperative association sells stock, then it must comply with the provisions of the Florida Securities Act just as any other issuer. Any doubt on this point should now be dispelled by the commission's statement that:

We wish to advise that in the past, several parties have pointed out that similar associations failed to comply with our act, but this merely served to cause such associations to meet with our requirements rather than excuse the new associations from complying with same.⁴⁸

44. "Time after time they [members of Florida Security Dealers Ass'n] showed their approval of individual items as they were read off by the Florida Securities Commission Director." Miami Herald, Oct. 17, 1956, P. 7-D, Col. 1.

45. See Harum, *Need for Reform in Security Dealers Legislation*. 12 U. MIAMI L. REV. 75 (1957).

46. Fla. Securities Comm'n., release No. 18 (Sept. 7, 1956).

47. *Id.* at p.2.

48. Fla. Securities Comm'n., release No. 12 (Dec. 82, 1955).

Transfers of Stock

At its 1957 session, the Florida Legislature adopted the Uniform Gifts to Minors Act.⁴⁹ Prominent among the provisions of this new legislation is one that specifies the manner in which gifts of securities to minors may be effected. More specifically, if the subject of the gift is a registered security, i.e., one which specifies the person entitled to receive it and is in such form that its transfer may be registered upon books maintained for that purpose by the corporation, a valid gift may be effected by registering it in the name of the donor, an adult member of the minor's family, a guardian of the minor or a trust company, followed by the words "as custodian for _____ under the Florida Gifts to Minors Act." If, however, the subject of the gift is a security not in registered form, delivery of it to an adult member of the minor's family, a guardian of the minor or a trust company, accompanied by a statement of gift in prescribed statutory form will result in an irrevocable gift to the minor. This new statute calls for careful examination by all attorneys and transfer agents.

Two recent cases involved the applicability and construction of the Uniform Stock Transfer Law.⁵⁰

In *Niccolls v. Jennings*,⁵¹ a Florida stock broker needed a certain amount of tangible assets to enable his business to comply with the net capital requirements of the Securities Exchange Act of 1934.⁵² Unable to supply this financing himself, the broker prevailed upon a friend to lend him 1,000 shares of stock under an agreement providing for repayment or replacement of the stock upon notice to him and to the Securities and Exchange Commission. But when the friend sought to reclaim her stock, the broker was not in a position to abide by his agreement. Accordingly, he embarked upon a fraudulent scheme whereby he prevailed upon other innocent parties to lend him stock; this stock he transferred to his friend in order to satisfy her repeated demands that he replace her shares. The substituted shares were indorsed in blank. Upon discovery of the broker's fraud, the deceived parties immediately sought repayment. The broker executed an assignment of all of his assets for the benefits of his creditors, but these assets were insufficient. The innocent victims then sought to compel the broker's friend to return the shares delivered to her by him. She defended on the ground that she was a bona fide purchaser for value under the applicable provisions of the Uniform Stock Transfer Law.⁵³ The court stated that ordinarily her contention would be sound, for the certificates were indorsed in blank and she had acted in good faith in receiving them. However, because of the fact that she had, for all practical purposes, put the broker in business, the court

49. FLA. SESSIONS LAWS, c. 57-13(1957).

50. FLA. STAT. c. 614 (1957).

51. 92 So.2d 829 (1957).

52. § 15 U.S.C.A. 48 Stat. 881 78(a) (1934).

53. FLA. STAT. §§ 614.02, 614.09 (1957).

looked upon her as having "clothed his business with an apparent condition of solvency and enabled him to attract the patronage of the public, including the other parties to this cause."⁵⁴ The court then proceeded to apply the rule that where one of two innocent parties must suffer through the act of a third person, the loss should fall upon the one whose conduct created the circumstances which enabled the third party to perpetrate the wrong.

In the second case,⁵⁵ plaintiff purchased shares of corporate stock at a sheriff's sale. He then presented his bill of sale to the secretary of the corporation and demanded that the shares be transferred to his name on the corporate books.⁵⁶ Upon refusal of the secretary, plaintiff sought a writ of mandamus to compel him to execute the transfer. Defendant raised the affirmative defense that the purchaser at the time of the sale, knew that other outstanding shares of stock, representing some of the shares purchased, had been pledged by the judgment debtor to secure his other debts. In holding this defense insufficient, the court relied on the Uniform Stock Transfer Law⁵⁷ and the fact that the plaintiff was entitled to rely on unpledged ownership of the shares by the judgment-debtor.

54. 92 So.2d at 833.

55. *Berger v. Beyerle*, 93 So.2d (FLA. 1957).

56. See FLA. STAT. § 55.31 (1957).

57. FLA. STAT. § 614.15 (1957).