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Business Associations—1963 Tennessee Survey

*Robert N. Covington**

I. Existence of Partnership—Effect of Licensing Statute
II. Shareholder's Right To Inspect Books
III. Duty of Majority Shareholders
IV. Enforceability of Corporate Note Made to Officer

Section two of the act creating Tennessee's new Law Revision Commission charges that body with the duty to study and report to the next legislature on "the laws governing the organization and operation of corporations, partnerships and other forms of business and social endeavor." The study is now roughly a year old and is reportedly making good headway. Since much of our law of business organizations may therefore be changed in the near future, this *Survey* has been abbreviated as much as possible. Four cases decided during 1963, however, seem likely to have some continuing impact, and these have been selected for treatment here.

I. Existence of Partnership—Effect of Licensing Statute

Complainant in *Lloyd v. Wiseman*[1] sought recovery of his share of the profits of a partnership dealing in real estate of which he was allegedly a member. Defendant answered that there was no partnership, and that complainant should be barred from recovery for failure to obtain a real estate broker's license. The Tennessee Court of Appeals affirmed a decision in favor of complainant.

The chancellor's finding that a partnership existed was based on testimony by complainant and one McCracken, another partner not involved in the suit. The testimony of both men was to the effect that defendant, complainant and McCracken agreed to work together in the real estate business and to share both profits and losses equally. The sharing of profits is by statute prima facie evidence of the existence of a partnership.[2] It is also true, however, that a number of American cases have failed to find a partnership to deal in real estate in spite of the presence of profit-sharing.[3] When profit sharing is combined with a sharing of losses, however, the instant decision is in accord with a majority of cases, and with Tennessee precedent.[4]

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1. 368 S.W.2d 303 (Tenn. App. E.S. 1963) (western section sitting at Knoxville).
2. Tenn. Code Ann. § 61-106(4) (1956).
3. 1 Rowley, Partnerships § 7.5 (2d ed. 1960).
4. Fowler v. Stone's River Nat'l Bank, 57 S.W. 209 (Tenn. Ch. App. 1899).

The court offered two bases for rejecting defendant's argument based on the failure to license. The first was that the partnership here dealt only in its own lands and was therefore excepted from the statute.[5] The second, more important for the development of partnership law, was that defendant was estopped from asserting the failure to license. By its citations of authority one is led to believe that the court might not be willing to apply the doctrine were the transactions engaged in malum in se.[6]

II. Shareholder's Right To Inspect Books

State ex rel. Lowell Wiper Supply Co. v. Helen Shop, Inc.[7] was a mandamus action to compel defendant corporation to permit relator, as a shareholder, to inspect corporate books and records. Defendant opposed the suit on two grounds: (1) that relator was not a shareholder; and (2) that relator's damages remedy under section 48-308 of the code is exclusive.

The shares to which relator asserted title were given him as security for a loan by the debtor, who admittedly was a shareholder. When the debtor was unable to repay the loan at the proper time, the shares were transferred to relator, and the transfer was subsequently recorded in defendant's books. Defendant alleged that it had not been advised whether this transfer was bona fide, and further alleged that the transfer was improper for lack of consent to the transfer by the former shareholder. The court found as a matter of fact that the former shareholder had acquiesced in the transfer of stock. Thus even had relator not been credited on the corporation's books with ownership of the shares, he would have been entitled to treatment as a shareholder.[8] Moreover, since defendant had listed relator as a stockowner and had for some time treated relator as a stockowner, defendant should be estopped from denying relator's title.[9]

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5. Tenn. Code Ann. § 62-1301 (1956). One wishes the court had commented on the language of the exemption more fully. It is limited to transactions "performed in the regular course of or as an incident to the management of such property and the investment therein. . . ." The precise meaning of "management" is left unclear. One wonders also whether the statute is in any way intended to protect persons in defendant's status.

6. See Memphis & Ark. River Packet Co. v. Agnew, 132 Tenn. 265, 273-75, 177 S.W. 949 (1915); 6A Corbin, Contracts § 1378, 1510-13 (1962); 1 Rowley, Partnerships § 6.7 at 86, nn.45, 46 (2d ed. 1960).

7. 362 S.W.2d 787 (Tenn. 1962).

8. Title in Tennessee has been viewed as going with the certificate. Tenn. Code Ann. § 48-1003 (1956); Figuers v. Sherrell, 181 Tenn. 87, 178 S.W.2d 629 (1944). The provisions of the Uniform Stock Transfer Act previously in force will be modified by the adoption of article 8 of the Uniform Commercial Code. For a brief survey of the changes, see Note, 22 Tenn. L. Rev. 842 (1953).

9. The court does not dwell on the estoppel point, doubtless because of the presence of an alternative basis of decision. One wishes the opinion had outlined the elements of the estoppel more clearly, for the very brief treatment given makes it difficult to

Section 48-308 gives shareholders who have wrongfully been denied access to corporate stock books a right to sue for a penalty of 50 dollars for each day of wrongful refusal. If defendant's argument in the instant case had been accepted, it would have been possible for a corporation to continue indefinitely to keep its records from a shareholder, so long as the corporation would be willing to pay the fifty dollars. Certainly the court is correct in holding that the traditional mandamus remedy remains available.[10]

The court also declined to revise the decree so as to require inspection of only those records made since relator became a shareholder. Conceding that a purchaser of shares has no greater rights than the prior holder, the court instructed the chancellor on remand to consider the possibility that relator's vendor had acquiesced in various corporate acts in seeing to it that the inspection order is carried out within reasonable bounds.[11]

III. Duty of Majority Shareholders

After several years of litigation and negotiation, the Phillips and Buttorff-Moore Dry Goods dispute is burning itself out, having exuded during its history rather more heat than light. The basic transactions which ignited the controversy, as enunciated by the Sixth Circuit in *Maggiore v. Bradford*,[12] were these:

> Brokers, who were made defendants in the action, acquired the shares of P & B on the order of Guy L. Comer with temporary financing. The shares were placed in the name of Church of Christ Foundation, a corporation not for profit, of which Mr. Comer was a trustee. Woodstock Corporation, a Comer company, with the authority of the Foundation and its subsidiary, First National Company, gave P & B an option to purchase the Moore shares at $45.00 a share. P & B loaned $2,000,000 to Woodstock secured by a

assess the ruling for future use. For a similar decision, also with very little discussion, see Bassin v. Enoch-Pearl Co., 140 N.J. Eq. 428, 54 A.2d 824, 826 (1947).

10. It is surprising that this point had not previously been adjudieated, since the statute has been on the books since 1929. Defendant's argument has a certain literal plausibility to it if one considers a statement from an opinion delivered prior to enactment of this statute: "[Mandamus] is regarded in both courts as in the nature of a prerogative writ, to be granted only in the high diseretion of the court, and to be applied only to those cases as to which no other remedy exists." Brown v. Crystal Ice Co., 122 Tenn. 239, 243, 122 S.W. 84, 85 (1909). The statement, however, was not absolutely necessary to the decision. Statutes of this type have generally been regarded as extending rather than restricting the right of inspection. See 5 Fletcher, Cyclopedia of Corporations § 2215.1 (rev. vol. 1952).

11. As this and other points of defense would indicate, defendant distrusted the relator's motivation. The court could find no evidence to support this doubt. In its discussion, however, it made it clear that it does not regard the common law right of inspection as absolute. See Wood v. Myers Paper Co., 3 Tenn. App. 128 (W.S. 1926), in which inspection was refused because of improper motives. The statute specifically retains the defense for the penalty action. Tenn. Code Ann. § 48-308 (1956).

12. 310 F.2d 519, 520 (6th Cir. 1962).

pledge of the Moore stock, which pledge was made by permission of the owners. The brokers through Woodstock gave First National Company an option to purchase 75,721 shares of the common stock of P & B, which carried the control of P & B. First National Company assigned its option on the P & B stock to the Foundation which exercised it. P & B exercised its option and purchased the Moore shares.

As of December 31, 1955 P & B had cash on hand of $953,335.53 and investments in government and other marketable securities totaling about $2,000,000. In order to make the loan to Woodstock and purchase the Moore stock, P & B liquidated its securities and borrowed additional money from a bank. The Comer Group had previously acquired the Moore shares by the use of Moore's assets and the shares were placed in the name of the Foundation.

These transactions were attacked by a derivative action brought in federal court by minority shareholders, seeking rescission of the sale. While the action was pending, the Moore stock transaction was in effect rescinded, for P & B resold its Moore stock to the Foundation for the forty-five dollars a share it had paid. Plaintiffs amended their complaint to seek recovery of operating losses sustained by P & B prior to the rescission and attorneys' fees incurred by the shareholders in the instant action. The district court held against plaintiffs on both counts.

The Sixth Circuit affirmed the district court's denial of recovery of operating losses, finding the lower court's decision that those losses were attributable to other causes to be adequately supported. On the liability of defendants for attorneys' fees, however, the court reversed. The district court had held that the evidence failed to show that the Comer interests actually exercised control of P & B. On this, the circuit court said simply that "the transaction speaks for itself." The court found it too difficult to believe that the P & B officers and directors would have entered into the maze of stock transfers involved unless guided by Comer and his associates.

Having found the Comer group to be responsible for P & B's conduct, the court went on to find that this conduct violated the fiduciary duty owed by dominant shareholders to minority shareholders. It was not necessary, it was felt, to decide whether under Tennessee law self-dealing of this sort is per se violative or whether the Tennessee standard is one of fairness; under either standard the court felt defendants' acts were culpable.[13] Reduced to essentials, this conduct amounted to "stripping P & B of its cash and marketable securities and requiring it to borrow money so that the Comer group

13. The Tennessee standard remains less than clearly defined. For a discussion concluding that fairness is the test when officers deal with the corporation see Roberts, *Business Associations–1960 Tennessee Survey*, 13 VAND. L. REV. 999-1004 (1960). For a general discussion of standards of conduct applicable to dominant shareholders, see 1 HORNSTEIN, CORPORATION LAW AND PRACTICE § 365 (1959).

could finance their controlling shares. . . ." Thus defendants would have been liable to rescind. Based on this holding, the court went on to award interest on the P & B funds used for the stock transfer, for the period from the date suit was filed to the date of rescission. Credit was allowed for dividends and interest paid to P & B by Woodstock and Moore.

Since the plaintiffs were now successful complainants who could be credited with benefitting the corporation by prosecution of this action, it was appropriate to award counsel fees to their attorneys.[14] The case was remanded to the district court for this purpose.

It should be noted that the court permitted this action even though plaintiffs had made no demand on the directors to act.[15] The court felt that the failure of the corporation to act for nearly a year after the action was commenced was sufficient proof that demand would have been futile.[16]

IV. Enforceability of Corporate Note Made to Officer

Plaintiff's decedent in *Fidelity Bankers Trust Co. v. Chapman Drug Co.*[17] had served for several years as treasurer of defendant corporation. While serving he from time to time made loans to defendant, receiving promissory notes in exchange. Three of these notes were signed by defendant's president, while ten were signed by decedent as treasurer, including the note on which this action was brought. Defendant argued two propositions: First, that decedent lacked authority to execute the note; and second, that the note was invalid because it was the result of self-dealing.

The court disposed of the points in reverse order. The opinion states the clearly correct rule that "the fiduciary relationship of a corporate officer to the corporation does not preclude the officer from lending the corporation money and taking a note therefor, in the absence of fraud or circumstances indicating detriment to the corporation."[18] To take any other view would be to preclude the persons most interested in the success of the business from giving it aid in the moments of financial distress which occur in the life of almost every commercial venture.

The question of authority was also decided for plaintiff on two alternative bases. While the board of directors had never specifically authorized decedent to execute notes to himself, this practice had been

14. See generally 2 Hornstein, *op. cit. supra* note 13, § 732.
15. *Id.* § 717.
16. See Akin v. Mackie, 203 Tenn. 113, 119-22, 310 S.W.2d 164 (1958).
17. 366 S.W.2d 528 (Tenn. App. E.S. 1962).
18. 366 S.W.2d at 532. *Accord, In re* Madelaine, Inc., 164 F.2d 419 (2d Cir. 1947); Goldstein v. Wolfson, 132 F.2d 624, 626 (2d Cir. 1943); Arnold v. Phillips, 117 F.2d 497, 503 (5th Cir. 1941).

engaged in for over a decade. The books, with which one would assume the board to be familiar, had shown these transactions clearly throughout the period. Moreover, defendant's president clearly knew of several of the transactions since he signed three notes payable to decedent. This pattern fits rather neatly into the traditional agency doctrine that "acquiescence by the principal in a series of acts by the agent indicates authorization to perform similar acts in the future."[19]

Even had the court not found decedent to have had authority to execute the notes, a holding for plaintiff would have been likely on the basis of ratification. Retention of benefits to which a principal is entitled only through an act of his agent purportedly on his behalf serves to affirm the transaction, provided the principal has knowledge of the relevant facts.[20]

19. Restatement (Second), Agency § 43(2) (1958). See also Gilman v. F. O. Bailey Carriage Co., 127 Me. 91, 141 Atl. 321 (1928) (loans to corporation by its general financial officer shown in audits circulated to board).

20. Restatement (Second), Agency § 99 (1958).