

# INDIANA COMMERCIAL COURT TREATISE



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# Indiana Commercial Court Treatise

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## Introduction

On May 16, 2019, the Indiana Supreme Court issued an order permanently establishing a commercial court system in Indiana after a three-year pilot project. The purpose of the Commercial Courts is:

1. To establish judicial structures that will help all court users by improving court efficiency;
2. To allow business and commercial disputes to be resolved with expertise, technology, and efficiency;
3. To enhance the accuracy, consistency, and predictability of decisions in business and commercial cases;
4. To enhance economic development in Indiana by furthering the efficient, predictable resolution of business and commercial law disputes;
5. And to employ and encourage electronic information technologies, such as e-filing, e-discovery, telephone/video conferencing, and also employ early alternative dispute resolution interventions, as consistent with Indiana law.

## The Indiana Commercial Courts and Judges

As of October 2022, ten commercial courts are permanently established in these counties:

Allen County – Judge Craig J. Bobay  
Elkhart County – Judge Stephen R. Bowers  
Floyd County – Judge Maria D. Granger  
Hamilton County – Judge Jon M. Brown  
Lake County – Judge John M. Sedia  
Madison County – Judge Mark K. Dudley  
Marion County – Judge Heather A. Welch  
St. Joseph County – Judge Cristal C. Brisco  
Vanderburgh County – Judge Thomas M. Massey  
Vigo County – Judge Lakshmi Reddy

Also instrumental in the implementation of the Commercial Courts was now retired Judge Richard G. D'Amour of Vanderburgh County. Additionally, Judge Steven L. Hostetler briefly served as a Commercial Court Judge in St. Joseph County.

## Acknowledgments

Work on this first edition of this treatise was overseen by the Commercial Court Handbook and Treatise subcommittee of the Commercial Court Committee. The subcommittee consisted of chair Hon. Craig J. Bobay, and attorneys Jeff L. Lund, Michael H. Michmerhuizen, Shane C. Mulholland, and Matt T. Troyer. Also contributing in the editing and compilation of the treatise was Indiana Office of Court Services Staff Attorney Amanda Wishin, and the following Commercial Court Law

Clerks: Kelley Blaine; Matt Danielson; Peter Elliot; Justin McGiffin; Mary Grace Monzel; Matt Senko; and Amina Young, née Thomas. The subcommittee is indebted to Professor (and former Indiana Supreme Court Justice) Frank E. Sullivan Jr., who, in addition to providing his editorial comments, also contributed the insightful introductory paragraphs found throughout this treatise.

## Note on Precedential value

The subcommittee has endeavored to present accurate, binding precedent when discussing substantive legal issues in this treatise. Because the law evolves, counsel and courts should be mindful of confirming the precedential value of all cases cited herein.

## Note on Judging Business and Commercial Law Litigation

Frank Sullivan, Jr.<sup>1</sup>

This note discusses two themes that permeate the adjudication of much business and commercial law litigation: reconciling applicable statutory and common law principles; and interpreting contracts.

### Common Law and Statutes

The constitutional doctrine of Separation of Powers mandates that because statutes are Legislative Branch enactments, they prevail over common law principles which are the product of Judicial reasoning. In tort litigation, there is frequent skirmishing over the propriety of using common law to defeat the applicability of a statutory provision; the argument is framed in terms of the derogation canon which implicitly acknowledges the primacy of statutes. *See, e.g., Stanley v. Walker*, 906 N.E.2d 852, 862 (Ind. 2009) (Dickson, J., dissenting) (describing as a “bedrock principle” that statutes in derogation of common law be strictly construed and citing *Dunson v. Dunson*, 769 N.E.2d 1120, 1124–25 (Ind. 2002); *McKnight v. State*, 658 N.E.2d 559, 562 (Ind. 1995); *McQuade v. Draw Tite, Inc.*, 659 N.E.2d 1016, 1018 (Ind. 1995); *Ind. State Highway Comm'n v. Morris*, 528 N.E.2d 468, 473 (Ind. 1988); *Loftus v. State*, 52 N.E.2d 488, 490 (Ind. 1944)).

Business entity litigation frequently presents judges with competing statutory and common law claims. But in contrast to tort law, statutes in derogation of the common law regularly accommodate if not give way to it.

Consider *Aronson v. Price*, 644 N.E.2d 864 (Ind. 1994), a leading case on a shareholder’s personal liability for the debts and obligations of an Indiana corporation. Spencer Aronson received a judgment from the trial court holding both the defendant corporation and its shareholder, Kent Price, liable caused during the restoration of Aronson’s classic 1957 4-Door Chevrolet Belair which

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he had been given by his wife. The trial court agreed with Aronson that Price was not entitled to the protection of the bedrock principle that a shareholder of a corporation is not personally liable for the debts and obligations of a corporation because Aronson had established grounds for “piercing the corporate veil.”

Ind. Code § 23-1-26-3(b) specifies that “a shareholder of a corporation is not personally liable for the acts or debts of the corporation,” subject to two exceptions not relevant in either *Aronson v. Price* or to this discussion. There are no grounds for “piercing the corporate veil” set forth in the Indiana Business Corporation Law (BCL); they are the creation of common law. Although the Indiana Supreme Court held that Price had no personal liability, it readily acknowledged that an Indiana court will impose personal liability where a party meets its burden of proving the grounds for piercing the corporate veil. Indeed, *Aronson* went so far as to say that the statute was (merely) a codification of the common law bedrock principle. *Aronson* at 867. The Court held, in other words, that notwithstanding the bedrock principle of limited liability expressed in the absolute language of § 23-1-26-3(b), that principle is subject to being overridden by common law piercing of the corporate veil.

In *Aronson*, Justice Dickson would have found liability on Price’s part as an agent for an undisclosed principal, namely, the corporation which had been operating using an unregistered assumed business name. *Aronson* at 869. He too appears to have been of the view that the language of the statute is subject to being overridden by a common law principle, *i.e.*, agent for an undisclosed principal.

In the same vein, the Indiana Court of Appeals has held the limited liability language in the Indiana limited liability company statute subject to common law piercing. The limited liability company statute is even more definitive than the BCL in expressing the bedrock principle of limited liability:

A member, a manager, an agent, or an employee of a limited liability company is not personally liable for the debts, obligations, or liabilities of the limited liability company, whether arising in contract, tort, or otherwise, or for the acts or omissions of any other member, manager, agent, or employee of the limited liability company.

Ind. Code § 23-18-3-3(a). Yet in *Troutwine Estates Dev. Co., LLC v. Comsub Design & Eng’g, Inc.*, 854 N.E.2d 890, 899 (Ind. Ct. App. 2006), the Court held that these “protections” would be “circumvent[ed]” if a claimant satisfied the common law requirements for piercing set forth in *Aronson*. While the Indiana Supreme Court has not addressed this question in the context of LLCs, *Troutwine* was followed by the Court of Appeals in *Pazmino v. Bose McKinney & Evans, LLP*, 989 N.E.2d 784 (Ind. Ct. App. 2013), and by federal district courts in a handful of diversity cases, *e.g.*, *MFP Eagle Highlands, LLC v. Am. Health Network of Indiana, LLC*, 2009 WL 77679, at \*9 (S.D. Ind. Jan. 9, 2009).

Another example of the interaction of the BCL with common law is *Fleming v. Int’l Pizza Supply Corp.*, 676 N.E.2d 1051 (Ind. 1997). Kenneth Fleming had dissented from a sale of the assets of International Pizza Supply Corporation and filed suit seeking the appraised value of his shares and, in separate counts, damages for fraud and breach of fiduciary duty on the part of Peter Jensen, the corporation’s majority shareholder.

The statute at issue was Ind. Code § 23-1-44-8(d) (at the time, subsection (c)) which provides “A shareholder . . . who is entitled to dissent and obtain payment for the shareholder's shares under this chapter . . . may not challenge the corporate action creating . . . the shareholder's entitlement.” The common law at issue was the right of a shareholder to pursue causes of action for fraud and breach of fiduciary duty for alleged misconduct by a majority shareholder.

Adding context to the dispute in *Fleming*, the statute at issue had been adopted by the legislature with the explicit purpose of overruling *Gabhart v. Gabhart*, 370 N.E.2d 345 (1977), which had held that in a merger with “no valid purpose,” dissenters could challenge the merger, including by seeking to enjoin it, in addition to seeking the appraised value of their shares. Following *Gabhart*, the General Assembly adopted the language in § 23-1-44-8(d) which carries an Official Comment which reads in part: “Given the potential for disruption of corporate transactions where a *Gabhart* rule applied to the BCL, the General Assembly adopted subsection ([d]) as a categorical statutory rule that shareholders entitled to dissenters' rights may not challenge the corporate action creating that entitlement. Hence, the kind of minority shareholder challenge to corporate action permitted by *Gabhart* under IC 23-1-5-7(c) is not permitted under subsection ([d]).” Official Comments to Ind. Code § 23-1-44-8.

In *Fleming*, Jensen sought summary judgment on the fraud and breach of fiduciary duty counts, arguing that appraisal was Fleming's exclusive remedy; that the statute reflected a conscious policy choice of the legislature between the rights of majority and minority shareholders. Fleming's response was that the statute did not preclude his actions for fraud and breach of fiduciary duty; that this case did not involve the issue of valid purpose to which *Gabhart* and the legislature's response was directed.

Notwithstanding the statute, the Court said that “shareholders in a closely-held corporation stand in a fiduciary relationship with one another and must deal fairly, honestly, and openly with the corporation and their fellow shareholders. *Fleming* 676 N.E.2d at 1056 (citing *Barth v. Barth*, 659 N.E.2d 559, 561 (Ind.1995)). Because of this, “a shareholder suffering compensatory damages proximately caused by the breach of such fiduciary duty or fraud must have a remedy therefor.” *Fleming* 676 N.E.2d at 1056. While “the legislature meant to limit a dissenting shareholder seeking payment for the value of the shareholder's shares to the statutory appraisal procedure[,] . . . the legislature did not foreclose the ability of dissenting shareholders to litigate their breach of fiduciary duty or fraud claims within the appraisal proceeding.” *Fleming* 676 N.E.2d at 1057. This could be accomplished, the Court said, “in the appraisal process [by] the shareholder to alleg[ing] that the value assigned to the shares in the merger or asset sale was too low because of the breach of fiduciary duty or fraud on the part of majority shareholders.” *Id.*

The bottom line is that even though the legislature, fortified by Official Comments, was quite specific in overruling common law principles that the Court had previously enunciated in *Gabhart*, the Court in *Fleming* preserved those common law principles by merging them into the new statutory regime.

A third example of the interaction of the BCL and common law is *Melrose v. Capitol City Motor Lodge, Inc.*, 705 N.E.2d 985 (Ind. 1998). This was a dispute between two of three shareholders in a closely held corporation, Herbert Melrose and Samuel Smulyan, over Smulyan's purchase for its cash surrender value of a policy owned by the corporation insuring Smulyan's life. Melrose challenged

the purchase as an impermissible conflict of interest under the statute and a breach of Smulyan's fiduciary duty of fair dealing to the corporation and fellow shareholders.

The BCL defines a conflict of interest transaction as "a transaction with the corporation in which a director of the corporation has a direct or indirect interest." Ind. Code § 23-1-35-2(a). It goes on to provide that a "conflict of interest transaction is not voidable by the corporation solely because of the directors interest in the transaction if any one (1) of the following is true:

(1) The material facts of the transaction and the director's interest were disclosed or known to the board of directors or a committee of the board of directors and the board of directors or committee authorized, approved, or ratified the transaction.

(2) The material facts of the transaction and the director's interest were disclosed or known to the shareholders entitled to vote and they authorized, approved, or ratified the transaction.

(3) The transaction was fair to the corporation.

*Id.* The statute, in other words, provides three alternatives for a conflict of interest transaction to pass muster.

Just as in *Fleming*, the Court said that "shareholders in a close corporation stand in a fiduciary relationship to each other, and as such, must deal fairly, honestly, and openly with the corporation and with their fellow shareholders." *Melrose* at 991 (quoting *Barth* at 561).

Here the Court said that the common law fiduciary duty at issue would be satisfied if all three of the alternatives set forth in the conflict of interest statute were met. *Id.* The Court did not say that meeting all of the alternatives in the conflict of interest statute was necessary to satisfy the common law fiduciary duties at issue but the careful lawyer would almost certainly be left with that takeaway.

In all three of the foregoing situations, despite reasonably absolute statutory language, the Indiana Supreme Court continued to deploy correlative common law principles in deciding the cases, although somewhat differently in each. In *Aronson*, the common law principles took precedence over the statute. In *Fleming*, the common law principles were merged into the statute. And in *Melrose*, the common law principles were deemed satisfied by compliance with the statutory requirements read in the conjunctive rather than disjunctive.

One area of the interaction of statute and common law likely to be confronted by the courts is the question of whether the fiduciary duty of LLC members to each other can be eliminated by contract.

Ind. Code § 23-18-4-4(a) provides with respect to LLCs: "A written operating agreement may . . . [m]odify, increase, decrease, limit, or eliminate the duties (including fiduciary duties) . . . of a member or manager." Yet "common law fiduciary duties, similar to the ones imposed on partnerships and closely-held corporations, are applicable to Indiana LLCs." *Purcell v. Southern Hills Investments, LLC*, 847 N.E.2d 991, 997 (Ind. Ct. App. 2006) (following *Credentials Plus, LLC v. Calderone*, 230 F. Supp. 2d 890, 900 (N.D. Ind. 2002).

If a member of an Indiana LLC sues a fellow member for breach of fiduciary duty and the LLC operating agreement has eliminated the common fiduciary duties of members to one another, will



the courts take an approach as in *Aronson*, or in *Fleming*, or in *Melrose* – or deploy another technique altogether?

## Contract Interpretation

No matter how hard lawyers try in drafting contracts to avoid ambiguity and foreclose disputes, the prospect always exists that disagreements will arise over how to interpret the terms of contracts and judges will be called upon to resolve them. Because the problem of contract interpretation arises with so much frequency, Indiana courts have developed a disciplined approach to addressing it.

First, “Indiana courts recognize the freedom of parties to enter into contracts and . . . presume that contracts represent the freely bargained agreement of the parties.” *Fresh Cut, Inc. v. Fazli*, 650 N.E.2d 1126, 1129 (Ind. 1995); *Weaver v. Am. Oil Co.*, 276 N.E.2d 144, 147 (Ind. 1971). “This reflects the principle that it is in the best interest of the public not to restrict unnecessarily persons’ freedom of contract.” *Fresh Cut, Inc.* 650 N.E.2d at 1129; *Raymundo v. Hammond Clinic Ass’n*, 449 N.E.2d 276, 279 (Ind. 1983).

Second, “[t]he ultimate goal of any contract interpretation is to determine the intent of the parties at the time that they made the agreement.” *Citimortgage, Inc. v. Barabas*, 975 N.E.2d 805, 813 (Ind. 2012).

Third, “construction of the terms of a written contract is a pure question of law for the court, reviewed de novo.” *Harrison v. Thomas*, 761 N.E.2d 816, 818 (Ind. 2002).

Fourth, a court will begin its interpretation of a contract “with the plain language of the agreement, reading it in context and, whenever possible, construing it so as to render each word, phrase, and term meaningful, unambiguous, and harmonious with the whole.” *Citimortgage* 975 N.E.2d at 813.

Fifth, “where the language of a written instrument is unambiguous . . . the parties’ intent is to be determined by reviewing the language contained within the ‘four corners’ of that written instrument.” *Ryan v. TCI Architects/Eng’rs/Contractors, Inc.*, 72 N.E.3d 908, 917 (Ind. 2017). “[E]xtrinsic evidence is not admissible to add to, vary or explain the terms of a written instrument if the terms of the instrument are susceptible of a clear and unambiguous construction.” *Univ. of S. Ind. Found. v. Baker*, 843 N.E.2d 528, 532 (Ind. 2006) (citation omitted). (“Extrinsic evidence is evidence relating to a contract but not appearing on the face of the contract because it comes from other sources, such as statements between the parties or the circumstances surrounding the agreement.” *CWE Concrete Const., Inc. v. First Nat’l Bank*, 814 N.E.2d 720, 724 (Ind. Ct. App. 2004) (citing BLACK’S LAW DICTIONARY 578 (7th ed. 1999), *trans. denied*, 831 N.E.2d 739 (Ind. 2005)).

“A contract is ambiguous if a reasonable person would find the contract subject to more than one interpretation.” *Citimortgage* 975 N.E.2d at 813. If a court finds ambiguous terms or provisions in the contract, the court “will construe them to determine and give effect to the intent of the parties at the time they entered into the contract.” *Id.* Courts may properly consider all relevant extrinsic evidence to resolve the ambiguity. *Baker* 843 N.E.2d at 535. Prior to 2006, Indiana courts drew a distinction between patent and latent ambiguities, holding “extrinsic evidence – both circumstantial and direct evidence of intention – . . . admissible to establish the existence of a latent ambiguity and

also to resolve it," but refusing "to admit extrinsic evidence to aid in the resolution of a patent ambiguity." *Id.* at 534–35. In 2006, the Indiana Supreme Court abandoned the latent/patent distinction and held that "where an instrument is ambiguous, all relevant extrinsic evidence may properly be considered in resolving the ambiguity." *Id.* at 535.

Sixth, the principle of *contra proferentem*: an ambiguous contract will be "construed against the party who furnished and drafted the agreement." *Celadon Trucking Servs., Inc. v. Wilmoth*, 70 N.E.3d 833, 839 (Ind. Ct. App.), *trans. denied*, 88 N.E.3d 1077 (Ind. 2017); *Rahn v. Sch. City of Gary*, 25 N.E.2d 441, 442 (Ind. 1940).

Despite the very strong presumption of enforceability of contracts that represent the freely bargained agreement of the parties, courts have refused to enforce private agreements on public policy grounds in three types of situations: (i) "agreements that contravene statute"; (ii) agreements that "clearly tend to injure the public in some way"; and (iii) agreements that are "otherwise contrary to the declared public policy of Indiana." *Fresh Cut, Inc.* 650 N.E.2d at 1130 (Ind. 1995).

The proper method of determining enforceability in such circumstances requires balancing: "(i) the nature of the subject matter of the contract; (ii) the strength of the public policy underlying the statute; (iii) the likelihood that refusal to enforce the bargain or term will further that policy; (iv) how serious or deserved would be the forfeiture suffered by the party attempting to enforce the bargain; and (v) the parties' relative bargaining power and freedom to contract." In a case involving "highly sophisticated parties" where "the parties' [had] relatively equal bargaining power and freedom to contract and . . . any other significant extenuating circumstances [were absent]," the court held that "any forfeiture that would be suffered . . . if the bargain were not enforced would be undeserved." *Cont'l Basketball Ass'n, Inc. v. Ellenstein Enters., Inc.*, 669 N.E.2d 134, 140-41 (Ind. 1996).

# Chapter 1: Non-Compete/Non-Solicitation/Non-Disclosure

## Introductory Note on Covenants Not to Compete

Frank Sullivan, Jr.

Litigation over covenants not to compete is ubiquitous and the case law is voluminous. At issue are the competing policy interests of freedom of contract and the ability to deploy one's labor freely. Indiana law's fealty to freedom of contract is so strong it needs no citation but respect for an individual's ability to deploy one's labor freely is engrained in law as well. For example, a contract restricting a lawyer from competing with a prior employer would violate Indiana Professional Conduct Rule 5.6(a).

A survey of case law shows the Indiana Supreme Court more reluctant over time to enforce covenants not to compete than the Indiana Court of Appeals has been in recent years.

The first Supreme Court decision of note was *Donahue v. Permacel Tape Corp.*, 234 Ind. 398, 127 N.E.2d 235 (1955), where an employee had agreed not to compete with his employer anywhere in the United States or Canada for three years following termination of employment. The Supreme Court unselfconsciously rejected the freely entered-into contract on grounds of public policy. It was simply unwilling to tolerate a covenant restricting employment to such a wide geographic area. And it was unwilling to sever or blue-pencil the contract to reduce the geographic coverage. While the law has backed off this position, the case illustrates a court rising up and giving a full-throated endorsement to the principle that this particular public policy –the ability to deploy one's labor freely – outweighs the public policy of freedom of contract.

Next came *Raymundo v. Hammond Clinic Ass'n*, 449 N.E.2d 276 (Ind. 1983), where the court was asked to enforce the liquidated damages provision of a physician's agreement that if he left employment, he would not practice medicine within 25 miles of the clinic for two years following termination of employment. Here the Court sided with the Hammond Clinic and awarded liquidated damages of \$25,000, which it held reasonable in light of the physician having generated \$103,000 in gross revenues for the clinic.

*Donahue* and *Raymundo* were unanimous decisions; not so was *Cent. Indiana Podiatry, P.C. v. Krueger*, 882 N.E.2d 723 (Ind. 2008), where a podiatrist had agreed not to compete with his employer in forty-three Indiana counties for two years following termination of employment. A three-judge majority of the Supreme Court blue-penciled the forty-three counties down to just three counties; the two dissenting justices would have affirmed the non-competition agreement in its entirety.

The Court was unanimous in *Heraeus Med., LLC v. Zimmer, Inc.*, 135 N.E.3d 150 (Ind. 2019), where a salesman had agreed not to recruit any employees of his former employer to work for a competitor. The Indiana Supreme Court refused to enforce the solicitation covenant or even to allow it to be revised pursuant to the blue pencil doctrine. Shortly thereafter, in *Am. Consulting, Inc. v. Hannum*

*Wagle & Cline Eng'g, Inc.*, 136 N.E.3d 208 (Ind. 2019), a divided opinion, the Supreme Court declared unenforceable the liquidated damages clauses of three employment contracts that would be triggered if the covered individuals engaged in competition with or recruited the employees of their former employer. While the Court in that case did not declare unenforceable covenants that explicitly prohibited competition, declaring unenforceable liquidated damages clauses linked to competition denied the defendant employer the very relief that the defendant employer in *Raymundo* had been provided.

Taken together, these five cases show restraint on the part of the Indiana Supreme Court in enforcing covenants not to compete. In three of them, the covenants were not enforced at all. In *Raymundo*, monetary relief was awarded pursuant to a modest liquidated damages clause. And in *Krueger*, the plaintiff was enjoined from practicing podiatry in Marion County but not any of the donut counties. It did so only after declaring "long held that noncompetition covenants in employment contracts are in restraint of trade and disfavored by the law."

By contrast, the Indiana Court of Appeals has almost without exception enforced non-competition agreements over the last five years:

- *Heraeus Med., LLC v. Zimmer, Inc.*, 123 N.E.3d 158, 167 (Ind. Ct. App. 2019), rev'd, 135 N.E.3d 150 (Ind. 2019).
- *Am. Consulting, Inc. v. Hannum Wagle & Cline Eng'g, Inc.*, 104 N.E.3d 573 (Ind. Ct. App. 2018), rev'd, 136 N.E.3d 208 (Ind. 2019).
- *SourceOne Grp., LLC v. Gage*, No. 18A-PL-2153, 138 N.E.3d 9942019 WL 6334657 (2019) (unpublished disposition), *trans. denied*, 145 N.E.3d 108.
- *Vickery v. Ardagh Glass Inc.*, 85 N.E.3d 852 (Ind. Ct. App. 2017).
- *Janowiak v. Watcon, Inc.*, No. 71A04-1512-PL-2154, 2016 WL 4245426 (Ind. Ct. App. Aug. 11, 2016) (unpublished disposition).
- *Duermit v. Odyssey Healthcare, Inc.*, No. 29A02-1503-PL-146, 2015 WL 9590759 (Ind. Ct. App. Dec. 31, 2015) (unpublished disposition).

Back in 2013, however, the Court of Appeals struck a strong blow for an employee against his former employer in *Guinn v. Applied Composites Eng'g, Inc.*, 994 N.E.2d 1256 (Ind. Ct. App. 2013), *trans. denied*. An employee who had signed a non-competition agreement went to work for a new employer. The former employer contacted the new employer, asserting the hiring had violated the non-competition agreement; the new employer terminated the employee shortly thereafter. On the employee's claim against the former employer for tortious interference with his employment with the new company, the Court of Appeals reversed the trial court's grant of summary judgment in favor of the former employer and remanded for a determination of whether the former employer's conduct was justified or fair and reasonable under the circumstances.

The foregoing cases examine contractual provisions involving agreements not to compete or, in *Heraeus*, not to solicit employees on behalf of a competitor. Standing on different footing have been two types of similar cases: (1) cases that allege misappropriation of confidential employer information, often trade secrets; and (2) cases involving non-competition covenants given in consideration for the sale of a business.

As to cases alleging misappropriation of confidential employer information, *Angie's List, Inc. v. Myers*, No. 29A02-1605-PL-1061, 2016 WL 7493406 (Ind. Ct. App. Dec. 29, 2016) (unpublished disposition), is one of many. The former employee-defendants had never signed non-competition agreements with the former employer and the latter's attempt to prevent them from working for a competitor was rejected by the court. But the court did find that because the employees' contracts contained covenants "not to take company documents and not to solicit employees away from the company," the employer was entitled to injunctive relief on these matters.

*Dicen v. New Sesco, Inc.*, 839 N.E.2d 684 (Ind. 2005), was a watershed decision of the Indiana Supreme Court that held that covenants not to compete ancillary to the sale of a business are viewed more favorably than those arising out of an employer-employee relationship. *Zollinger v. Wagner-Meinert Eng'g, LLC*, 146 N.E.3d 1060 (Ind. Ct. App. 2020), *trans. denied*, and *Kuntz v. EVI, LLC*, 999 N.E.2d 425 (Ind. Ct. App. 2013), strongly follow *Dicen*. *Foncannon Tax & Fin. Servs., LLC v. Stephen C. Gubler, P.C.*, No. 82A05-1606-CC-1263, 83 N.E.3d 1273, 2017 WL 1349334 (Ind. Ct. App. 2017) (unpublished disposition), stands for the same principle although more tentative as to result.

The bottom line on non-competes is that Indiana trial courts and the Indiana Court of Appeals have in recent years enforced them robustly as a matter of freedom of contract and private ordering. The infrequent decisions of the Indiana Supreme Court, spaced over 70 years, have been more favorable to employees' freedom to market their labor. However, the enforceability of provisions protecting confidential employer information and of non-competition covenants given in consideration of the sale of the business seems unquestioned.

As to the future, the enforceability of non-competes may become a subject of debate as Indianapolis grows in prominence as a technology center. Covenants not to compete are void as a matter of statutory law in California, and that policy is thought to be part of the reason for the Silicon Valley technology boom. Policymakers might well contend that Indiana would be better off – and would better promote entrepreneurship and innovation – if it, too, would declare covenants not to compete unenforceable.

## 1. NON-COMPETITION COVENANTS

### 1.1. Generally

"Our supreme court has long held that noncompetition covenants in employment contracts are disfavored in the law, and we will construe these covenants strictly against the employer and will not enforce an unreasonable restriction." *Clark's Sales & Serv. v. John D. Smith & Ferguson Enters.*, 4 N.E.3d 772, 780 (Ind. Ct. App. 2014) *quoting Cent. Indiana Podiatry, P.C. v. Krueger*, 882 N.E.2d 723, 728-29 (Ind. 2008). Post-employment restraints are scrutinized with particular care because they are often the product of unequal bargaining power and because the employee is likely to give scant attention to the hardship he may later suffer through loss of his livelihood. *Id.*; *see also* Restatement (Second) of Contracts, § 188 cmt. g (1981). Courts must construe noncompetition

covenants strictly against the employer. *Clark's Sales & Serv.*, 4N.E.3d at 780; *see also Cent. Indiana Podiatry, P.C. v. Krueger*, 882 N.E.2d 723, 728-29 (Ind. 2008).

## 1.2. Reasonableness Requirement

For a non-competition agreement to be enforceable it must be reasonable. *Raymundo v. Hammond Clinic Asso.*, 449 N.E.2d 276, 280 (Ind. 1983). In order for a noncompetition agreement to be enforceable, it must reasonably relate to protection of a specific interest. *Clark's*, 4 N.E.3d at 780. Reasonableness is a question of law. *Id.* Courts will not enforce an unreasonable restriction. *Id.*

The reasonableness of a non-competition agreement is a two-part inquiry: (1) the employer must show it has a legitimate interest to be protected by the agreement; and 2) the employer bears the burden to show that the agreement is reasonable in scope as to the (a) time, (b) activities, and (c) geographic area restricted. *See Vickery v. Ardagh Glass, Inc.*, 85 N.E.3d 852, 861 (Ind. Ct. App. 2017); *see also Hannum Wagle & Cline Eng'g, Inc. v. Am. Consulting, Inc.*, 64 N.E.3d 863, 877 (Ind. Ct. App. 2016).

### 1.2.1. Legitimate Protectable Interest

To demonstrate a legitimate protectable interest, the employer must show that the employee possesses some advantage, the use of which would make it unfair to allow that employee to compete with the former employer. *Coates v. Heat Wagons, Inc.*, 942 N.E.2d 905, 913 (Ind. Ct. App. 2011); *Pathfinder Communs. Corp. v. Macy*, 795 N.E.2d 1103, 1110 (Ind. Ct. App. 2003). The employee should only be enjoined if he has gained some advantage at the employer's expense, which would not be available to the general public. *Clark's Sales & Serv.*, 4 N.E.3d at 780-81; *Norlund v. Faust*, 675 N.E.2d 1142, 1154 (Ind. Ct. App. 1997), *clarified on reh'g*, 678 N.E.2d 421.

#### 1.2.1.1. GOODWILL AND PROTECTABLE INTERESTS.

Indiana courts have held "the advantageous familiarity and personal contact which employees derive from dealing with an employer's customers are elements of an employer's 'good will' and are a protectable interest which may justify a restraint." *Clark's Sales & Serv.*, 4 N.E.3d at 781. Goodwill includes:

1.2.1.1.1. **Secret or confidential information related to customers.** Elements of this good will include 'secret or confidential information' such as the names and addresses and requirements of customers. *Seach v.*

*Richards, Dieterle & Co.*, 439 N.E.2d 208, 213 (Ind. Ct. App. 1982) (citing *Donahue v. Permacel Tape Corp.*, 234 Ind. 398, 410, 127 N.E.2d 235, 240 (Ind. 1955)).

- 1.2.1.1.2. **Representative contact.** “In addition, in industries where personal contact between the employee and the customer is especially important due to the similarity in product offered by the competitors, the advantage acquired through the employee’s representative contact with the customer is part of the employer’s good will, regardless of whether the employee has access to confidential information.” *Clark’s Sales & Serv.*, 4 N.E.3d at 781 (citing *Gleeson v. Preferred Sourcing, LLC*, 883 N.E.2d 164, 173 (Ind. Ct. App. 2008)).
- 1.2.1.1.3. **Reputation.** A business may have a special interest in the reputation of an employee, which is a cognizable value which the business can protect with a restrictive covenant. *Pathfinder Communs. Corp. v. Macy*, 795 N.E.2d 1103, 1113 (Ind. App. 2003) (citing generally to *T.K. Communications, Inc. v. Herman, et al.*, 505 So. 2d 484 (Fla. Dist. Ct. App. 1987)). Good will generated between a customer and a business is also a protectable interest, and includes the business relationship, the names and address of customers, and the advantage acquired through representative contact. *Gleeson v. Preferred Sourcing, LLC*, 883 N.E.2d 164, 173 (Ind. Ct. App. 2008).
- 1.2.1.1.4. **Name and Identity.** A business can protect against other businesses attempting to, intentionally or accidentally, confuse customers by copying or mirroring the name of the business (*McCart v. H & R Block*, 470 N.E.2d 756 (Ind. Ct. App. 1984)) as opposed to a cause for unfair competition. The covenant can be present to prevent “piracy” of the customer base by a “mutinous partner.” *Raymundo v. Hammond Clinic Asso.*, 449 N.E.2d 276, 279 (Ind. 1983).
- 1.2.1.1.5. **Where there is no evidence that customers selected a business based on the employee, no legitimate protectable interest based on goodwill**

**exists.** See *Duneland Emergency Physician's Med. Group, P.C., v. Brunk*, 723 N.E.2d 963, 966-67 (Ind. Ct. App. 2000) (holding that because there was no evidence that any patients selected a hospital emergency room based on which physicians work there, the facts in *Duneland* were "distinguishable from situations where a physician leaves a practice and attempts to take patients with him or her in violation of a non-compete clause"). *Id.* at 966-67. See also *Great Lakes Anesthesia, P.C. v. O'Bryan*, 99 N.E.3d 260, 271 (Ind. Ct. App. 2018) ("Great Lakes does not point to evidence that the O'Bryans were hired to *increase* a customer base, akin to a traditional salesman").

### 1.2.2. Reasonableness of Scope

Indiana law strongly discourages employers' attempts to draft unreasonably broad and oppressive covenants. *Clark's*, 4 N.E.3d at 786 (citing *Product Action Int'l, Inc. v. Mero*, 277 F. Supp. 2d 919, 924 (S.D. Ind. 2003)). A covenant not to compete is reasonable only when: the restraint is necessary to protect the employer, is not unreasonably restrictive, and is not against public policy; all viewed in a totality of the circumstances test. *4408, Inc. v. Losure*, 175 Ind. App. 658, 659-60 (1978). A noncompetition agreement drafted so broadly as to prohibit seemingly harmless conduct may be unreasonable in view of all of the circumstances of a particular case. *Clark's* at 782.

If a court finds that portions of the covenant are unreasonable, under the Blue Pencil Doctrine, the court may not create a reasonable restriction under the guise of interpretation, since this would subject the parties to an agreement they have not made. *Burk v. Heritage Food Serv. Equip.*, 737 N.E.2d 803, 811 (Ind. Ct. App. 2000).

#### 1.2.2.1. TIME

Time is the least defined characteristic of non-competition covenants, with the majority of case law being conclusory, stating particular times that are reasonable without providing rationale. See generally *Gleeson v. Preferred Sourcing, LLC*, 883 N.E.2d 164 (Ind. Ct. App. 2008); *Leatherman v. Mgmt. Advisors, Inc.*, 448 N.E.2d 1048, 1050 (Ind. 1983); *Buanno v. Weinraub*, 81 N.E.2d 600, 603 (Ind. 1948). In an unpublished decision, the Court of Appeals stated that the main determination is the "nature of the protectable interest" and if a broad geographical or temporal scope is necessarily required. *SourceOne Grp., LLC v. Ray*



*Gage & Myers & Gage*, No. 18A-PL-2153, 138 N.E.3d 994, 2019 Ind. App. Unpub. Lexis 1483, 2020 Westlaw 1868104 (Ind. Ct. App. Nov. 27, 2019) (unpublished decision), trans. denied.

Indefinite time limitations for non-competes are prohibited. *Harvest Ins. Agency, Inc. v. Inter-Ocean Ins. Co.*, 492 N.E.2d 686, 690 (Ind. 1986). When considering the temporal aspect of a definitely limited covenant, the personal relationship existing between the employee and the customer must be taken into account, with the time restriction to be no longer than when the customer will cease to be influenced by the personal relationship the employee was able to establish while in the employment of his employer. *Standard Register Co. v. Cleaver*, 30 F. Supp. 2d 1084, 1097-98 (N.D. Ind. 1998). The *Standard Register* case, which contains the most comprehensive restatement of Indiana Law concerning temporal restrictions, further holds that:

The reasonableness of a time restraint in a restrictive covenant is generally judged using three criteria: its relation to the employer's protectable interest; the possible injury to the employee by precluding him from pursuing his occupation as a means of support; and whether it will interfere with the interests of the general public by depriving it of the restricted party's services.

As discussed *supra*, protection of an employer's customers is a legitimate basis for a covenant. However, the mere opportunity of the employee to become acquainted with a customer does not determine the need, nor the duration of the protection, rather the personal relationship existing between the employee and the customer must be taken into account so as to indicate the likelihood that the employee would be able to take the customers of his employer when he leaves. Generally speaking, the influence of the employee over the customers of his employer depends on the extent to which the customer identifies the employee with the business in hand and replaces the contact he would otherwise have with the employer with a personal relationship which binds him to the employee instead of to the employer's business. This situation will occur most easily where the employee is the main, if not the sole, contact of the employer with the customer. Salesmen, or "route men" most typically fall into this category. *Id.* "In all those instances, the employer's need for protection is very urgent, and a restrictive covenant will seldom be held unenforceable . . . if the duration of the restraint does not exceed a period of time of approximately one to two years."

An appropriate gauge by which to determine the length of time necessary for the protection of the employer's interests depends on the period of time necessary to obliterate in the customer's mind the identification formed during the term of employment between the employer and the employee. In other words, the question is: "After what period of time will the customer cease to be influenced by the personal relationship the employee was able to establish while in the employ of his employer?" In making this determination, an important factor is the frequency and regularity of the contact between the employee and the customer. Thus, in the salesmen route cases, situations where the customer is visited frequently at relatively short intervals by the employee, courts are reluctant to approve durations of more than one or two years. However, as to those salesmen who visit their customers with less regularity, and at longer intervals, the duration of the restraint may be substantially longer, depending on the period of time usually elapsing between repeat orders. *Standard Register Co.* 30 F. Supp. 2d at 1097-98.

#### 1.2.2.2 Extensions of Covenants

In an order granting preliminary injunctive relief, a court cannot extend the duration of a non-compete covenant, even if the contract provides that the restrictions shall be extended by the terms of the contract, during litigation. *Kuntz v. EVI, LLC*, 999 N.E.2d 425, 432 (Ind. Ct. App. 2013); see also *Hannum Wagle & Cline Eng'g, Inc. v. Am. Consulting, Inc.*, 64 N.E.3d 863 (Ind. Ct. App. 2016). However, one older Indiana decision has held that injunctive relief beyond the terms of the covenant may be appropriate when there are special or extenuating circumstances. *F. W. Means & Co. v. Carstens*, 428 N.E.2d 251, 261 (Ind. Ct. App. 1981). What constitutes "special" or "extenuating" circumstances are not well-defined and whether *Means* remains good law is yet to be determined.

#### 1.2.2.3 Temporal Restrictions in Other Jurisdictions

Other jurisdictions have similar difficulties with the temporal aspect of non-compete covenants. North Carolina examines temporal duration as a balance of the duration against the territory covered. *Hartman v. W.H. Odell & Assocs., Inc.*, 117 N.C. App. 307, 312, 450 S.E.2d 912, 917 (1994). Courts have found as reasonable: covenants lasting six months and covering North and South America (*Okuma Am. Corp. v. Bowers*, 181 N.C. App. 85, 92, 638 S.E.2d 617, 622 (2007)); a five-year covenant limited to one city (*Welcome Wagon Int'l, Inc. v. Pender*, 255 N.C. 244, 120 S.E.2d 739 (1961)); and as unreasonable, a

five-year covenant that covered any county the employer of an asbestos removal specialist had a presence. *Masterclean of N.C., Inc. v. Guy*, 82 N.C. App. 45, 50, 345 S.E.2d 692, 695 (1986).

Under Michigan law, a reasonableness standard is used to interpret duration of covenants, contemplating if an increased duration will impede customer choice. *Coates v. Bastian Bros., Inc.*, 741 N.W.2d 539, 544 (2007). The covenant is then read in the context of the type of work the employee did, and the geographical restrictions being put in place. *Mid Mich. Med. Billing Serv. v. Williams*, No. 323890, 2016 Mich. App. LEXIS 319, at \*14 (Ct. App. Feb. 18, 2016). “[C]ovenants not to compete will not be stricken simply because they are unlimited in time. Instead they are enforced during a period deemed reasonable.” *Compton v. Joseph Lepak, DDS, PC*, 154 Mich. App. 360, 367, 397 N.W.2d 311, 314 (1986). Michigan courts have found covenants of three years, involving corporate secrets, as reasonable (*Actuator Specialties v. Chinavare*, No. 297915, 2011 Mich. App. LEXIS 2133, at \*15 (Ct. App. Dec. 1, 2011)); as well as agreements that included prohibitions of three and five years, for an accountant and insurance salesman (*Follmer, Rudzewicz & Co., P.C. v. Kosco*, 420 Mich. 394, 362 N.W.2d 676 (1984)). Michigan courts are also amenable to extending the duration of a covenant beyond “its stated expiration date.” *Thermatoool Corp. v. Borzym*, 227 Mich. App. 366, 375, 575 N.W.2d 334, 338 (1998).

Delaware generally states that the duration of a covenant must “be reasonable in scope and duration.” *TriState Courier & Carriage, Inc. v. Berryman*, No. 20574-NC, 2004 Del. Ch. LEXIS 43, at \*40 (Ch. Apr. 15, 2004). “Reasonableness of duration must be determined based upon the nature of the employee’s position and the context of a particular industry.” *Del. Express Shuttle v. Older*, No. 19596, 2002 Del. Ch. LEXIS 124 \*54 (Ch. Oct. 23, 2002). Delaware courts have found: a sales manager’s covenant of three years unreasonable, until reduced to two years (*Del. Express Shuttle v. Older*, No. 19596, 2002 Del. Ch. LEXIS 124, at \*54 (Ch. Oct. 23, 2002)); as invalid, a covenant of two years where the employee was a nurse (*FP UC Holdings, LLC v. Hamilton*, No. 2019-1029-JRS, 2020 Del. Ch. LEXIS 110, at \*31 (Ch. Mar. 27, 2020)); and as valid a covenant for five years where a large sum of money was paid for the right (*Kan Di Ki, LLC v. Suer*, No. 7937-VCP, 2015 Del. Ch. LEXIS 191, at \*67-68 (Ch. July 22, 2015)). Delaware permits the extension of a covenant if there is a legitimate business interest and if the court has considered: 1) whether the plaintiff initially sought a preliminary injunction, 2) whether a preliminary injunction actually had been issued against the defendant, 3) if a preliminary injunction was issued,

has it expired, and 4) whether the defendant engaged in the prohibited activities before the issuance of a preliminary injunction. *Deloitte & Touche USA LLP v. Lamela*, Civil Action No. 1542-VCP, 2007 Del. Ch. LEXIS 44, at \*21 (Ch. Apr. 6, 2007).

In New York, a covenant must be "reasonable in time and area and not unduly burdensome." *Crown IT Servs. v. Koval-Olsen*, 11 A.D.3d 263, 264, 782 N.Y.S.2d 708, 710 (App. Div. 2004). The court must "consider, among other things, such factors as the size and location of the market areas to be served by the parties and the length of time needed to provide [defendant] with a reasonable period in which to secure [its] ownership in the good will of the business." *Frank v. Metalico Rochester, Inc.*, 2019 NY Slip Op 05863, ¶ 2, 174 A.D.3d 1407, 1412, 106 N.Y.S.3d 467, 473 (App. Div.). Covenant duration can be determined from "cognizable boundaries" and is not necessarily required to be specifically stated in the covenant. *Morizio v. Roeder*, 2018 NY Slip Op 50027(U), ¶ 5, 58 Misc. 3d 1210(A), 94 N.Y.S.3d 539 (Sup. Ct.). New York courts have found as valid, two-year covenants involving a construction risk management officer (*Frenkel Benefits, LLC v. Mallory*, 2016 NY Slip Op 06109, ¶ 3, 142 A.D.3d 835, 838, 37 N.Y.S.3d 508, 511 (App. Div.)); and 18 months for an accountant (*Bdo Seidman v. Hirshberg*, 93 N.Y.2d 382, 387, 690 N.Y.S.2d 854, 855, 712 N.E.2d 1220, 1222 (1999)).

#### 1.2.2.2. ACTIVITIES.

In general, non-compete covenants can only restrict former employees from acting in a similar employment capacity for a competitor, as covenants that bar employment "in any capacity" will likely be found unenforceable. *See, e.g. Distrib. Serv. v. Stevenson*, 16 F.Supp. 3d 964, 974 (S.D. Ind. 2014). Thus, a covenant that restricts the employee from competing with portions of the business with which he was never associated is invalid. *Clark's Sales & Serv.*, 4 N.E.3d at 782; *Seach*, 439 N.E.2d at 214.

##### 1.2.2.2.1. Contact with past or prospective customers overly broad.

Although present customers are a protectable interest of an employer, a non-compete may be overly broad and unreasonable if it seeks to protect a customer base spanning the entire term of an employee's employment. *Clark's*, 4 N.E.3d 781-82. The unrestricted use of the terms "past and prospective clients" is vague

and over-broad; present clients are a protectable interest. *Seach*, 439 N.E.2d at 213. However, at least one Court has found a protectable interest in past customers during the employee's tenure if the employee had contact with every one of his employer's customers. *Carroll v. Long Tail Corporation*, 167 N.E.3d 750, 2021 (Ind. Ct. App. 2021), *trans. denied*.

1.2.2.2.2. "In any capacity" language is generally unenforceable.

A noncompete covenant's activity restriction may only limit activities affecting the former employer's legitimate protectable interest. See *Burk v. Heritage Food Serv. Equip.*, 737 N.E.2d 803, 811 (Ind. Ct. App. 2000). In *Burk*, Indiana Court of Appeals held language in a non-compete was overly broad and unenforceable because the provision effectively prohibited the defendant from working for a competitor "in any capacity." *Burk*, 737 N.E.2d at 812.

A court should stringently review the terms of the non-compete to ensure that the terms do not have the functional effect of preventing the employee from joining the competitor in any capacity or performing services that he never performed for his previous employer.

1.2.2.2.3 Indiana Physician Non-Competes

Recently passed legislation requires that, after July 1, 2020, physician non-compete agreements must include provisions that:

- 1). The employer must provide the physician with a copy of any concerns tendered by a patient in the two years before the physician's departure;
- 2). That the employer provides the physician's last known contact information to requesting former patients;
- 3). That the physician has access to or copies of medical records associated with a patient seen by the leaving physician within the last two years;
- 4). That the physician be provided with an option to purchase release from the non-compete obligation;

5). Any medical records provided must be in an accessible format.  
(See Ind. Code. 25-22.5-5.5).

### 1.2.2.3. GEOGRAPHIC AREA

As a general rule, a covenant not to compete that contains no geographic limitations is void. *Struever v. Monitor Coach Co.*, 294 N.E. 2d 654, 655-56 (Ind. Ct. App. 1973). Whether a geographic scope is reasonable depends on the interest of the employer that the restriction serves. *Clark's*, 4 N.E.3d at 783; *Cent. Indiana Podiatry, P.C. v. Krueger*, 882 N.E.2d 723, 728-29 (Ind. 2008). "Know-how" or "unique skills" derived from the employer may justify a wider geographic scope. *Krueger*, 882 N.E.2d at 730.

An employee does not have to perform services in every "nook and cranny" of the geographic area for the restriction to be reasonable. *Raymundo v. Hammond Clinic Association*, 449 N.E.2d 276, 282 (Ind. 1983). However, in order to be enforceable, a non-competition covenant must only apply to a reasonable geographic area. *Krueger*, 882 N.E.2d at 729. In most instances, a geographic restraint upon a former employee must be limited to the area of the employee's sales territory. *Harvest*, 492 N.E.2d at 690.

In *Unger v. FFW Corp.*, 771 N.E.2d 1240 (Ind. Ct. App. 2002), the Indiana Court of Appeals found a geographic restriction reasonable where the restriction limited the employee from participating in any business competitive with the business of the former employer in the six counties adjacent to the county where the former employer was located. *Unger*, 771 N.E.2d at 1245. Additionally, where "trade secrets" or a "confidential relationship" exist, the covenant is eligible for a more expansive geographic scope. *Slisz v. Munzenreider Corp.*, 411 N.E.2d 700 (Ind. Ct. App. 1980).

## 1.3. Liquidated Damages Provisions

Liquidated or stipulated damage provisions are often contained in non-competition agreements. Courts have varied on their enforceability and the following sets forth frequently enunciated standards therefor, as well as a sampling of such decisions. For a graphic example of the varying approaches of Indiana judges, see *American Consulting, Inc. v. Hannum Wagle & Cline Engineering, Inc.*, discussed in 1.3.5 below, where the trial court judge, one Court of Appeals judge, and three Supreme Court justices found liquidated damage provisions unenforceable that two Court of Appeals judges and two Supreme Court justices would have enforced.

### 1.3.1. Definitional material.

The question of whether a liquidated damages clause is valid is a pure question of law for the court. *Coffman v. Olson & Co., P.C.*, 906 N.E.2d 201, 209 (Ind. Ct. App. 2009); *Gershin v. Demming*, 685 N.E.2d 1125, 1127-28 (Ind. Ct. App. 1997).

A typical liquidated damages provision provides for the forfeiture of a stated sum of money upon breach without proof of actual damages. *Pinnacle Healthcare, LLC v. Sheets*, 17 N.E.3d 947, 954 (Ind. Ct. App. 2014); *Patel v. United Inns, Inc.*, 887 N.E.2d 139, 150 (Ind. Ct. App. 2008).

Liquidated damages provisions are generally enforceable where the nature of the agreement is such that when a breach occurs the resulting damages would be uncertain and difficult to ascertain. *Pinnacle Healthcare, LLC*, 17 N.E.3d at 954. The stipulated sum will not be allowed as liquidated damages unless it may fairly be allowed as compensation for the breach. *Id.*

### 1.3.2. Liquidated damages must be proportional to loss likely to occur.

Indiana courts are tolerant of provisions within contracts that provide for liquidated damages. *Coffman*, 906 N.E.2d at 209; *Gershin*, 685 N.E.2d at 1127-28.

Where the sum stipulated in the agreement is not greatly disproportionate to the loss likely to occur, the provision will be accepted as a liquidated damages clause and not as a penalty. *Coffman*, 906 N.E.2d at 209; *Gershin*, 685 N.E.2d at 1127-28.

### 1.3.3. Disproportionate liquidated damages will be viewed as a penalty and unenforceable.

Where the sum sought to be fixed as liquidated damages is grossly disproportionate to the loss which may result from the breach, the courts will treat the sum as a penalty rather than as liquidated damages. *Coffman*, 906 N.E.2d at 209; *Gershin*, 685 N.E.2d at 1127-28.

In determining whether liquidated damages are a penalty, the facts, the intention of the parties, and the reasonableness of the stipulation under the circumstances of the case are all considered. *Coffman*, 906 N.E.2d at 209; *Gershin*, 685 N.E.2d at 1127-28.

1.3.4. See the following cases:

*Raymundo v. Hammond Clinic Ass'n*, 449 N.E.2d 276 (Ind. 1983) (liquidated damages of \$25,000 held reasonable in light of the physician having generated \$103,000 in gross revenues for the clinic over a period of less than one year).

*Seach v. Richards, Dieterle & Co.*, 439 N.E.2d 208 (Ind. Ct. App. 1982) (liquidated damages clause calling for “three times the former employer’s gross annual billing to clients contacted, advised, visited, or in any way solicited” was unenforceable because it created a penalty by proscribing acts ranging anywhere from contacting to advising the former employer’s clients);

*Hahn v. Drees, Perugini & Co.*, 581 N.E.2d 457 (Ind. Ct. App. 1991) (The court found the liquidated damages clause to be an unenforceable penalty when the clause required the former employee to pay the former employer three times the fees received as a result of breaching the noncompetition agreement. The court found the clause overly broad since there was no differentiation between contact with customers without a business context, and contact within a business context pertaining to the covenant);

*Coffman*, 906 N.E.2d at 210 (Indiana court of appeals held trial court correctly found liquidated damages provision to be a penalty where it required defendant, a certified public accountant, to pay at least twice, and up to three times the prior year’s gross billings for each client if he conducted “any accounting service.”).

1.3.5. *American Consulting, Inc. v. Hannum Wagle & Cline Engineering, Inc.*, 136 N.E.3d 208 (Ind. 2019).

*Covenants at issue*: Knowles’s employment agreement required him to pay “liquidated damages” upon breach of the agreement’s (1) non-competition covenant in an amount equal to 45 percent of all fees and other amounts that ASI had billed to former customers lost to Knowles’s new company during the twelve-month period immediately preceding the breach and (2) employee non-recruitment covenant in an amount equal to 50 percent of each employee’s total compensation from ASI for the twelve months immediately preceding such employee’s termination of employment with ASI. Lancet’s and Day’s employment agreements required each of them to pay upon breach of the agreement’s employee non-recruitment covenant “liquidated damages” in an amount equal to 100 percent of each improperly recruited employee’s annual salary for the preceding calendar year. 136 N.E.3d at 210.



*Trial Court [Judge Welch]:* [T]he liquidated damages provisions . . . are punitive and thus unenforceable. . . . This figure may not adequately account for injuries suffered by the aggrieved party; or it could exceed them if the aggrieved party is able to quickly move on following such a breach of contract. . . . The clause allows damages to balloon out of control in the event of multiple employee exits, as has been the case here, regardless of the level of Knowles' involvement or the amount of actual damages suffered by ASI. . . . [T]he valuation of the damages far exceeds what [ASI] could have reasonably expected to suffer. . . . No. 49D01–1503–PL–7463, Order at 34 (Sept. 13, 2016).

*Court of Appeals Majority [Judges Robb and Pyle]:* (1) These were negotiated agreements, in which the parties agreed in clear and explicit terms that liquidated damages were appropriate. (2) The relative bargaining power of the parties was reflected in the agreements, in that the agreements had different provisions and different damages calculations depending on the employee's tenure and position. (3) The actual damages are difficult to calculate because of the widespread and ongoing nature of the contacts between the HWC Parties and ASI employees and clients. (4) The actual damages are difficult to calculate because ASI was required to seek and train multiple new people due to the HWC Parties' targeted recruitment efforts. (5) The actual damages are difficult to calculate because the nature of the business means ASI could have lost only some or all of any one client's business due to HWC's interference. 104 N.E.3d at 588-89. [Judge Riley dissenting would have affirmed the trial court's judgment.]

*Supreme Court Majority [Justice David, joined by Chief Justice Rush and Justice Goff]:* the agreed damages provisions were unreasonable on their face. The liquidated damages for breach of the non-solicitation clauses would have amounted to an aggregate of \$686,000 for the three employees combined, the breach of the non-competition clause "could be in the range of millions of dollars," and the plaintiff had not shown that these damages were correlated to its actual losses. 136 N.E.2d at 213.

*Supreme Court dissent [Justice Slaughter, joined by Justice Massa]:* Majority essentially relieves Defendants of [their burden of showing the damages are unenforceable penalties] by concluding that the liquidated-damages clauses are 'problematic on their faces.'" This ignores "four substantive considerations: each liquidated-damages provision includes a causation requirement; an employee's value to an employer—and the resulting loss when the employee leaves—is reflected by that employee's salary; [employer] is seeking individualized damages for separate breaches of contract; and there is nothing inappropriate about a high-level, equity-owning employee having contractual restrictions different from those of lower-level employees." 136 N.E.2d at 213.

## 1.4. Covenants not to compete ancillary to the sale of a business.

Covenants not to compete ancillary to the sale of a business are viewed more favorably than those arising out of an employer-employee relationship. *Dicen v. New SESCO, Inc.*, 839 N.E.2d 684 (Ind. 2005).

*Zollinger v. Wagner-Meinert Eng'g, LLC*, 146 N.E.3d 1060 (Ind. Ct. App.), *trans. denied*, 153 N.E.3d 1111 (Ind. 2020), and *Kuntz v. EVI, LLC*, 999 N.E.2d 425 (Ind. Ct. App. 2013), strongly follow *Dicen*.

*Foncannon Tax & Fin. Servs., LLC v. Stephen C. Gubler, P.C.*, No. 82A05-1606-CC-1263, 83 N.E.3d 1273, 2017 Ind. App. Unpub. Lexis 466, 2017 Westlaw1349334 (Ind. Ct. App. Apr. 12, 2017) (unpublished disposition), stands for the same principle although more tentative as to result.

## 1.5. Choice of Law

Ordinarily a choice of law issue will be resolved only if it appears there is a difference in the laws of the potentially applicable jurisdictions. *Allen v. Great Am. Res. Ins. Co.*, 766 N.E.2d 1157, 1162 (Ind. 2002). *Accord, Ky. Nat'l Ins. Co.*, 919 N.E.2d at 575; *Hartford Acc. & Indem. Co. v. Dana Corp.*, 690 N.E.2d 285, 291 (Ind. Ct. App. 1997) (citing *Barron v. Ford Motor Co. of Canada Ltd.*, 965 F.2d 195, 197 (7th Cir. 1992)). *see also Simon v. U.S.*, 805 N.E.2d 798, 805 (Ind. 2004).

Where cases are brought in Indiana, Indiana choice of law doctrines control. *Nat'l Union Fire Ins. Co. v. Standard Fusee Corp.*, 940 N.E.2d 810, 813 (Ind. 2010); *Allen v. Great Am. Res. Ins. Co.*, 766 N.E.2d 1157, 1162 (Ind. 2002); *Hubbard Mfg. Co., Inc. v. Greeson*, 515 N.E.2d 1071, 1073 (Ind. 1987). (More generally, choosing the appropriate state substantive law is a decision to be made by the court of the state in which the action is pending. *Ky. Nat'l Ins. Co. v. Empire Fire & Marine Ins. Co.*, 919 N.E.2d 565, 575 (Ind. Ct. App. 2010); *Travelers Ins. Co. v. Rogers*, 579 N.E.2d 1328, 1330 (Ind. Ct. App. 1991); and *Alli v. Eli Lilly and Co.*, 854 N.E.2d 372, 376 (Ind. Ct. App. 2006).)

Indiana's choice of law provisions generally favor contractual stipulations as to governing law. *Id.*; *see also Allen v. Great Am. Reserve Ins. Co.*, 766 N.E.2d 1157, 1162 (Ind. 2002).

Indiana's choice of law rule for contract actions was famously stated in *W.H. Barber v. Hughes* as follows:

"The court will consider all acts of the parties touching the transaction in relation to the several states involved and will apply as the law governing the transaction the law of that state with which the facts are in most intimate contact." 223 Ind. 570, 63 N.E.2d 417, 423 (1945) (emphasis added).

See *Nat'l Union Fire Ins. Co. v. Standard Fusee Corp.*, 940 N.E.2d 810, 814 (Ind. 2010), for a detailed discussion of the historical importance of *W.H. Barber* to the development of choice of law principles nationally as well as its applicability where contracts do not stipulate a choice of law provision.

This requires courts to apply the law of the forum with the most intimate contacts to the facts. *OVR'S Acquisition Corp. v. Community Health Servs.*, 657 N.E.2d 117, 124 (Ind. Ct. App. 1995). The court must consider all acts of the parties touching the transaction in relation to the several states involved and will apply as the law governing the transaction the law of that state in which the facts are in most intimate contact. *Ky. Nat'l Ins. Co.*, 919 N.E.2d at 575. The following are representative of the factors to consider: (1) the place of contracting, (2) the place of negotiation, (3) the place of performance, (4) the location of the subject matter of the contract, and (5) the domicile, residence, nationality, place of incorporation and place of business of the parties. *Id.*; *Employers Ins. of Wausau v. Rectical Foam Corp.*, 716 N.E.2d 1015, 1024 (Ind. Ct. App. 1999); *Eby v. York-Division, Borg-Warner*, 455 N.E.2d 623, 626 (Ind. Ct. App. 1983).

## 1.6 National Trends of Non-Compete Covenants

A national trend may be developing that disfavors enforcement of non-compete covenants. The states of Maine, Washington, Maryland, Rhode Island, New Hampshire, and Oregon have all enacted new restrictions on non-compete covenants including minimum earning amounts earned by the employee to be bound. The state of California takes a hard stance against enforcement of non-competes, with narrow exceptions for non-solicitation clauses. Washington D.C. is poised to enact a complete bar (with minor exceptions) on non-compete covenants, pending the signature of the Mayor and the subsequent review by Congress. Additionally, Congress, in 2018, 2019, and 2020, and the Federal Trade Commission in 2020, have considered proposals to limit or ban non-compete covenants.

## 1.7 Other Routinely Litigated Issues

*Assignability* – As a general rule, non-compete covenants are personal services contracts and cannot be assigned without the employee's consent. *SDL Enters., Inc. v. Dereamer*, 683 N.E.2d 1347, 1350 (Ind. Ct. App. 1997).

*Nonparties to the non-compete* – “One not a party to a noncompetition agreement may be enjoined from assisting a party to such an agreement from breaching the same.” *Kladis v. Nick’s Patio, Inc.*, 735 N.E.2d 1216, 1221 (Ind. Ct. App. 2000).

## 2. NON-SOLICITATION COVENANTS

### 2.1. Generally

Non-solicitation covenants generally prohibit an employee from soliciting or encouraging other employees, independent contractors, or clients/customers of the employer to leave the employer or reduce the business they transact with the employer. *See generally, Hannum*, 64 N.E.3d at 869-71.

Non-solicitation covenants are often included in employment agreements alongside non-competition and non-disclosure covenants. *See generally, Pinnacle Healthcare, LLC v. Sheets*, 17 N.E.3d 947, 950, 956 (Ind. Ct. App. 2014); *Dicen v. New Sesco, Inc.*, 839 N.E.2d 684 (Ind. 2005); *Zimmer, Inc. v. Davis*, 922 N.E.2d 68 (Ind. Ct. App. 2010). Non-solicitation covenants include, but are not limited to, the non-solicitation of customers and employees, with geographic scope as an included component. *Heraeus Med., Ltd. Liab. Co. v. Zimmer, Inc.*, 123 N.E.3d 158, 168 (Ind. Ct. App. 2019).

“Solicitation” is the act or an instance of requesting or seeking to obtain something; a request or petition. *Enhanced Network Solutions Group, Inc. v. Hypersonic Techs. Corp.*, 951 N.E.2d 265, 268 (Ind. Ct. App. 2011).

### 2.2. Reasonableness Standard

Non-solicitation covenants are subject to the same reasonableness standards as non-competition covenants with regard to legitimate protectable interest and time, geographic, and activity restrictions. *Heraeus Med., Ltd. Liab. Co. v. Zimmer, Inc.*, 123 N.E.3d 158, 166 (Ind. Ct. App. 2019).

### 2.3. Duty of Loyalty

In addition to non-solicitation agreements, employees are charged with a common law fiduciary duty of loyalty to their current employer. *SJS Refractory Co., LLC v. Empire Refractory Sales, Inc.*, 952 N.E.2d 758, 768 (Ind. Ct. App. 2011).

An employee who plans to leave his current job and go into competition with his current employer must walk a “fine line.” *SJS Refractory Co.*, 952 N.E.2d at 768; *Kopka, Landau & Pinkus v. Hansen*, 874 N.E.2d 1065, 1070 (Ind. Ct. App. 2007). Prior to his termination, an employee must refrain from actively and directly competing with his employer for customers and employees and must continue to exert his best efforts on behalf of his

employer. *SJS Refractory Co.*, 952 N.E.2d at 768; *Kopka, Landau & Pinkus v. Hansen*, 874 N.E.2d at 1070. An employee may make arrangements to compete with his employer, such as investments or the purchase of a rival corporation or equipment. *SJS Refractory Co.*, 952 N.E.2d at 768; *Kopka, Landau & Pinkus v. Hansen*, 874 N.E.2d at 1070. However, the employee cannot properly use confidential information specific to his employer's business before the employee leaves his employ. *SJS Refractory Co.*, 952 N.E.2d at 768; *Kopka, Landau & Pinkus v. Hansen*, 874 N.E.2d at 1070. These rules balance the concern for the integrity of the employment relationship against the privilege of employees to prepare to compete against their former employers without fear of breaching their fiduciary duty of loyalty. *SJS Refractory Co.*, 952 N.E.2d at 768; *Kopka, Landau & Pinkus v. Hansen*, 874 N.E.2d at 1070-71.

### **3. REMEDIES FOR BREACH OF RESTRICTIVE COVENANTS**

#### **3.1. Enforcement of the restrictive covenant**

##### **3.1.1. Injunctive relief**

A preliminary injunction cannot be extended because to do so would violate the purpose of a preliminary injunction and so it must be dissolved at end of a reasonable time period, excepting certain other defenses. *Hannum Wagle & Cline Eng'g, Inc. v. Am. Consulting, Inc.*, 64 N.E.3d 863, 882 (Ind. Ct. App. 2016). A court cannot extend a restrictive covenant beyond its geographic, temporal, or activity scope. *Id.* (with Fn. 18 stating that geographic area was not at issue in this case).

##### **3.1.2. Monetary damages**

Lost profits are an acceptable measure of damages in actions involving violations of covenants not to compete. *Hahn v. Drees, Perugini & Co.*, 581 N.E.2d 457, 463 (Ind. Ct. App. 1991).

#### **3.2. Blue Pencil Doctrine**

"Indiana courts employ the 'blue pencil doctrine' to revise unreasonable noncompetition agreements. This doctrine, though, is really an eraser. Under the blue pencil doctrine, courts can make overbroad covenants reasonable by deleting language, but they may not add terms—even if the agreement contains a clause authorizing a court to do so. Here, the overbroad covenant cannot be blue-penciled to render it reasonable; so we vacate the section of the trial court's preliminary injunction purporting to enforce that provision." *Heraeus Med., LLC v. Zimmer, Inc.*, 135 N.E.3d 150, 151-52 (Ind. 2019) *overruling, in part, Smart Corp. v. Grider*, 650 N.E.2d 80 (Ind. Ct. App. 1995).

Noncompetition agreements restrict former employees from using valuable information obtained during their employment—such as trade secrets or confidential client data—to harm their former employers. But because these agreements "are in restraint of trade," courts enforce them only if they are reasonable. *Krueger*, 882 N.E.2d at 728-29; *see also Dicen v. New Sesco, Inc.*, 839 N.E.2d 684, 687 (Ind. 2005). If a court deems a restrictive covenant unreasonable, it may apply the "blue pencil doctrine," severing unreasonable, divisible portions and then enforcing the reasonable parts that remain. *Dicen*, 839 N.E.2d at 687." *Heraeus Med., LLC v. Zimmer, Inc.*, 135 N.E.3d 150, 152-153 (Ind. 2019).

Under this doctrine, a court may excise unreasonable, divisible language from a restrictive covenant-by erasing those terms-until only reasonable portions remain. *Heraeus Med., LLC*, 135 N.E.3d at 153; *Blue-Pencil Test*, Black's Law Dictionary (10th ed. 2014); *Krueger*, 882 N.E.2d at 730; *Dicen*, 839 N.E.2d at 687. The "blue pencil" doctrine, does not allow a court to rewrite a noncompetition agreement by adding, changing, or rearranging terms. *Heraeus Med., LLC*, 135 N.E.3d at 153; *Krueger*, 882 N.E.2d at 730; *Clark's Sales & Serv., Inc.*, 4 N.E.3d at 783-84. Importantly, the blue pencil doctrine applies to all restrictive covenants within noncompetition agreements, not just prohibitions against working for a competitor. *Heraeus Med., LLC*, 135 N.E.3d at 153; *See, e.g., Burk v. Heritage Food Serv. Equip., Inc.*, 737 N.E.2d 803, 814-15 (Ind. Ct. App. 2000) (blue-penciling an overbroad customer non-solicitation covenant).

The doctrine allows an employer to draft a reasonable and enforceable noncompetition agreement, while discouraging the employer from overreaching. *Heraeus Med., LLC*, 135 N.E.3d at 153. The doctrine also protects parties' expectations by not subjecting them to an agreement they did not make. *Heraeus Med., LLC*, 135 N.E.3d at 154; *see also, Licocci v. Cardinal Assocs., Inc.*, 445 N.E.2d 556, 561 (Ind. 1983).

Entities are not allowed to insert language into contracts that leaves the burden of creating reasonableness on the courts. Chief Justice Rush wrote: "Consistent with these cases, we conclude that parties may not, by 'adding a magic phrase' like the Kolbe Agreement's reformation clause, 'delegate to the courts the task of drafting reasonable agreements.' While reformation clauses might encourage an interpreting court to blue-pencil an agreement, they do not allow a court to overstep the bounds of Indiana's blue pencil doctrine by adding terms. To reason otherwise would spell the end of Indiana's blue pencil doctrine by encouraging employers to draft obviously overbroad restrictive covenants and to then rely on courts to narrow them just enough to be reasonable. This would frustrate the parties' reasonable expectations, since courts cannot, after the fact, assume what the parties intended when they entered into the agreement." *Heraeus Med., LLC* 135 N.E.3d at 155.

### 3.3. Declare unenforceable

If the court finds that the restrictive covenant is not reasonable to protect the stated interest and that the restriction cannot be fixed through blue-penciling, the court may declare the entire restrictive covenant unenforceable. *Heraeus Med., LLC*, 135 N.E.3d at 155.

## 4. UNIFORM TRADE SECRETS ACT

The Indiana Uniform Trade Secrets Act (IUTSA) protects against the unauthorized disclosure of trade secret information. See Ind. Code § 24-2-3 *et. seq.* It is based on the 1979 Uniform Trade Secret Act (UTSA), drafted and revised by the Uniform Law Commission. *Id.* In 1982, Indiana became the 6th State to adopt the UTSA. See <https://www.uniformlaws.org/committees/community-home?CommunityKey=3a2538fb-e030-4e2d-a9e2-90373dc05792> (last visited Dec. 22, 2020). As of this writing, the UTSA has been adopted by 49 of 50 States, with New York the only state yet to adopt the UTSA. *Id.*

The IUTSA creates a cause of action to sue to protect trade secret information independent of a written agreement, but most non-disclosure provisions in employment agreements will also oblige an employee against unauthorized use and/or disclosure of trade secrets.

### 4.1. Elements:

In general, Indiana law holds that a violation of the IUTSA has occurred when:

- 1) a person;
- 2) misappropriates;
- 3) a Trade Secret under the Act.

Ind. Code § 24-2-3-2.

### 4.2. Definitions:

#### 4.2.1. Person

A “person” under the IUSTA can be “a natural person, limited liability company, corporation, business trust, estate, trust, partnership, association, joint venture, government, governmental subdivision or agency, or any other legal or commercial entity.” Ind. Code § 24-2-3-2.

The expansive definition, and lack of Indiana case law on the topic, provides that nearly any recognized legal entity may potentially be liable under the IUSTA if they misappropriate trade secret information.

#### 4.2.2. Misappropriation

The action which constitutes the violation of the IUSTA is misappropriation of Information. Ind. Code § 24-2-3-2. This applies both to those who commit the misappropriation as well as those who are recipients of misappropriated Information. *Id.* The Information does not necessarily have to be actually misappropriated for the aggrieved party to seek a remedy. *Id.* The IUTSA creates liability for “threatened” Misappropriation as well. Ind. Code § 24-2-3-3(a). This prospective remedy permits the aggrieved party to try to prevent damage before the unauthorized disclosure of Information regardless of whether there was any intent to disclose the trade secret Information. *Vickery v. Ardagh Glass, Inc.*, 85 N.E.3d 852, 864 (Ind. Ct. App. 2017).

A few states, such as Illinois have adopted the doctrine of inevitable disclosure, which allows a plaintiff to prove trade-secret misappropriation by demonstrating that a former employee inevitably would disclose trade secrets to the new employer given the former employee's job duties and knowledge. *See Strata Mktg., Inc. v. Murphy*, 740 N.E.2d 1166, 1178, (Ill. App. Ct. 2000). Indiana has not adopted the doctrine.

- Misappropriation through acquisition of trade secret Information

A recipient of a trade secret commits Misappropriation through: “Acquisition of a trade secret of another by a person who knows or has reason to know that the trade secret was acquired by improper means.” Ind. Code § 24-2-3-2(1).

“Improper means” for the purposes of Misappropriation under the IUTSA “includes theft, bribery, misrepresentation, breach or inducement of a breach of a duty to maintain secrecy, or espionage through electronic or other means.” Ind. Code § 24-2-3-2.

Generally, the “persons” who commit this form of misappropriation will likely be employees who leave their current employer to work for a competitor, as they are the ones who would have had access to the information. *See* Ind. Code § 24-2-3-2. If the employee impermissibly obtains trade secret Information prior to joining the competitor, the employee will likely have committed at least threatened misappropriation under the IUTSA. *See Vickery*, 85 N.E.3d 852 (Ind. Ct. App. 2017). If the competitor knew that the employee was bringing improperly-acquired trade secret information with them, that competitor could be found liable for misappropriation as well. *See AGS Capital Corp. v. Prod. Action Int'l, LLC*, 884 N.E.2d 294 (Ind. Ct. App. 2008).



- Misappropriation through disclosure or use of trade secret Information

The IUTSA also punishes misappropriation via unauthorized disclosure or use of the trade secret. Ind. Code § 24-2-3-2(2)(A-C) defines this type of misappropriation as:

Disclosure or use of a trade secret of another without express or implied consent by a person who:

- (A) Used improper means to acquire knowledge of the trade secret;
- (B) At the time of disclosure or use, knew or had reason to know that his knowledge of the trade secret was:
  - (i) Derived from or through a person who had utilized improper means to acquire it;
  - (ii) Acquired under circumstances giving rise to a duty to maintain its secrecy or limit its use; or
  - (iii) Derived from or through a person who owed a duty to the person seeking relief to maintain its secrecy or limit its use; or
- (C) Before a material change of his position, knew or had reason to know that it was a trade secret and that knowledge of it had been acquired by accident or mistake.

Ind. Code § 24-2-3-2(2).

Ind. Code § 24-2-3-2(2)(A) further defines misappropriation via improper acquisition of trade secret Information to include actions by a person who knows or has reason to know the secret was misappropriated. If that person were to then go on and use or disclose the improperly-acquired trade secret, that person would have also committed a second act of misappropriation. *Infinity Prods. v. Quandt*, 810 N.E.2d 1028, 1033 (Ind. 2004) (finding that the trial court could have found a second party in breach of the Act without having been the unfaithful employee).

Ind. Code § 24-2-3-2(2)(B)(i) involves a situation where the person learned the information from another who had impermissibly obtained the Information, and the person was aware at the time of disclosure. Importantly, the person must have known the source of the Information obtained the trade secret through improper means. *Id.* If the person was not aware that the trade secret was improperly obtained at the time of disclosure, the person is not liable. *Infinity Prods.*, 810 N.E.2d at 1033.

Ind. Code § 24-2-3-2(2)(B)(ii)-(iii) contemplates a situation where a person acquires the trade secret Information legitimately but then proceeds to impermissibly disclose the Information to another person. *Id.*

Ind. Code § 24-2-3-2(2)(B)(ii) applies to the person who had legitimately obtained the trade secret information. Under the auspices of the IUTSA, that person would be bound not to disclose of that information under Ind. Code § 24-2-3-2(2)(B)(ii). *Comentis, Inc. v. Purdue Research Found.*, 765 F. Supp. 2d 1092, 1101 (N.D. Ind. 2011).

Ind. Code § 24-2-3-2(2)(B)(iii) applies to persons who obtain the trade secret through another person who legitimately acquired the Information. *Id.* For example, a competitor may hire a competitor's employee under many circumstances. *Comentis, Inc.*, 765 F. Supp. 2d . at 1100. That employee would still be precluded from disclosing his or her old firm's trade secrets to the competitor. *Id.* If the competitor obtains the trade secret information from the new hire in any way and uses it, that employer could be liable for misappropriation. *Id.*

Ind. Code § 24-2-3-2(2)(C) makes a person liable for knowingly disclosing a trade secret even if the acquisition of the trade secret was an accident or a mistake.

#### 4.2.3. Trade Secret

Finally, a trade secret is defined under the IUSTA as being information that:

- Derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use; and
- is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

Ind. Code § 24-2-3-2.

Stated differently, Indiana courts have identified four primary characteristics of trade secrets:

- Information;
- Provides independent economic value to owner;
- Not generally known or readily ascertainable; and
- Subject to efforts to maintain secrecy.

*Ackerman v. Kimball Int'l*, 634 N.E.2d 778, 783 (Ind. Ct. App. 1994) vacated in part, adopted in part, 652 N.E.2d 507 (Ind. 1995); See also *Hydraulic Exch. & Repair, Inc. v. KM Specialty Pumps, Inc.*, 690 N.E.2d 782, 785-86 (Ind. Ct. App. 1998); *Advanced Tactical Ordnance Sys., Ltd. Liab. Co. v. Real Action Paintball, Inc.*, No. 1:12-CV-296 JVB, 2015 U.S. Dist. LEXIS 50738, at \*4 (N.D. Ind. Apr. 17, 2015).

#### 4.2.4. Information

Under the IUTSA, "Information" broadly includes any "formula, pattern, compilation, program, device, method, technique, or process...." Ind. Code § 24-2-3-2. Products and services that businesses place in the chain of commerce have been recognized as trade secrets. *Michels v. Dyna-Kote Industries, Inc.*, 497 N.E.2d 586 (Ind. Ct. App. 1986); *Weston v. Buckley*, 677 N.E.2d 1089 (Ind. Ct. App. 1997). Trade secret Information can also comprise business's internal operations Information, such as customer lists and product pricing Information. *Ackerman v. Kimball Int'l*, 634 N.E.2d 778 (Ind. Ct. App. 1994), *aff'd*, 652 N.E.2d 507, 783-784 (Ind. 1995). Skills developed by employee while working for an employer do not, by themselves, constitute protectable trade secret Information. *Brunner v. Hand Indus., Inc.*, 603 N.E.2d 157, 160 (Ind. Ct. App. 1992); *Frederick v. Prof'l Bldg. Maint. Indus., Inc.*, 168 Ind. App. 647, 649 (Ind. Ct. App. 1976). "What constitutes trade secret information is a determination for the court to make as a matter of law." *Franke v. Honeywell, Inc.*, 516 N.E.2d 1090, 1093 (Ind. Ct. App. 1987).

- Independent Economic Value

There are two aspects to the economic value inquiry for trade secrets contemplated by statute: A) that the Information provides at least some economic value; and B) that the value relies on not being known by a competitor. Ind. Code § 24-2-3-2.

The first aspect of Information is that "what constitutes proprietary or trade secret information is a determination for the court to make as a matter of law." *Franke v. Honeywell, Inc.*, 516 N.E.2d 1090, 1093 (Ind. Ct. App. 1987). It is possible that even if a business has put effort into the creation of something like a list of policy holders, that information in the hands of a rival is independently without value and thus, not a trade secret. *Id.*

The second aspect of economic value, wherein the value stems from not being available to competitors, requires that the information actually be taken. *Primecare Home Health v. Angels of Mercy Home Health Care, L.L.C.*, 824 N.E.2d 376, 382 (Ind. Ct. App. 2005). As for customer lists and other internal documents, the more Information contained in the list derived from independent efforts of the firm, the more likely the internal document will derive economic value from not being generally known or readily ascertainable. *Hydraulic Exch. & Repair v. KM Specialty Pumps*, 690 N.E.2d 782, 786 (Ind. Ct. App. 1998).

Generally, if a competitor could gain some commercial advantage by obtaining the Information at issue, then the Information likely satisfies the economic value requirement. See *Ackerman v. Kimball Int'l*, 634 N.E.2d 778 (Ind. Ct. App. 1994).

- Not generally known or readily ascertainable

“Not generally known” refers to whether the Information is already publicly available. Publicly available Information, such as records of names and addresses, would not, by itself, constitute a protectable trade secret. See, e.g., *Hydraulic Exch. & Repair, Inc. v. KM Specialty Pumps, Inc.*, 690 N.E.2d 782, 786 (Ind. Ct. App. 1998) (the customer list in this case was protected trade secret, because it contained more information than just names and address). Additionally, if a company were to disclose Information via a publicly available forum such as a company website, that Information could no longer qualify as a protectable trade secret. *M.K. Plastics Corp. v. Rossi*, 838 N.E.2d 1068, 1076-77. (Ind. Ct. App. 2005).

“Readily ascertainable” refers to Information that is not necessarily public, and to keep trade secret protections the owner must take “reasonable though not extravagant measures to protect its secrecy.” *Flotec, Inc. v. S. Research*, 16 F. Supp. 2d 992, 1000 (S.D. Ind. 1998). For example, Information relating to a technique or design that can be discovered through reverse engineering a product can be considered readily ascertainable and is not subject to trade secret protection. *Id.* If a competitor would have to engage in substantial effort in order to discover the Information, then the Information could still be protected under the IUTSA. *Amoco Prod. Co. v. Laird*, 622 N.E.2d 912, 919 (Ind. 1993).

- Subject to efforts to maintain secrecy

Finally, the Information must be subject to efforts to maintain secrecy. *Zemco Mfg. v. Navistar Int'l Transp. Corp.*, 759 N.E.2d 239, 246 (Ind. Ct. App. 2001). Even if the Information qualifies as a trade secret under each

prong, IUTSA will not apply if the company did not properly secure its Information. *Id.* at 246-247.

Determining the appropriate steps to protect potential trade secret Information relies on an analysis of the company procedures and the Information at issue. *Id.* at 246. There are no particular requirements on how to maintain secrecy, but case law suggests that those seeking to protect their Information must clearly show that they have reasonably attempted to protect their trade secrets from disclosure. *Id.* Generally, non-disclosure agreements are a common practice that Indiana courts have given great deference to indicate a company attempted to maintain secrecy. *Steve Silveus Ins., Inc. v. Goshert*, 873 N.E.2d 165, 179-80 (Ind. Ct. App. 2007). Where a company takes measures with its own employees but does very little to protect information from outside sources, courts can find as a matter of law the company did not take reasonable steps to maintain the secrecy of its information. *Zemco Mfg. v. Navistar Int'l Transp. Corp.*, 759 N.E.2d 239, 250 (Ind. Ct. App. 2001).

With respect to electronic Information, procedures such as password protection and policies regarding access to certain files may display reasonable efforts to maintain secrecy. *Patriot Homes, Inc. v. Forest River Hous., Inc.*, 2006 U.S. Dist. LEXIS 45486 (N.D. Ind. June 21, 2006), *in part*, 489 F. Supp. 2d 865 (N.D. Ind. 2007), *vacated, in part*, 512 F.3d 412 (7th Cir. Ind. 2008). Where company allows all employees to freely access all computer and paper files without any additional protocol, the security efforts may be deemed insufficient under the IUTSA. *Coleman v. Vukovich*, 825 N.E.2d 397, 405 (Ind. Ct. App. 2005).

### **4.3. Remedies for violations of the IUTSA**

#### **4.3.1. Injunctive relief**

The Act authorizes courts to enter injunctive relief to prevent both threatened and/or actual misappropriation. Ind. Code § 24-2-3-3(a). The misappropriation does not have to occur before the court enters an injunction. *Vickery*, 85 N.E.3d 852, 864 (Ind. Ct. App. 2017). Upon a proper showing, the court may compel affirmative acts to protect trade secrets. Ind. Code § 24-2-3-3(c). While the IUTSA requires a court to terminate an injunction upon request once the trade secret no longer exists, a court may continue the injunction for a reasonable period of time to ensure no commercial advantage from the alleged misappropriation exits. *Wolfe v. Tuthill Corp., Fill-Rite Div.*, 516 N.E.2d 1074, 1076 (Ind. Ct. App. 1987), *superseded*, 532 N.E.2d 1 (Ind. 1988) (affirming that

permanent injunctions may be entered under the IUTSA). A permanent injunction may be entered if the facts or circumstances warrant such relief. *Id.*

In an action under this chapter, a court shall preserve the secrecy of an alleged trade secret by reasonable means, which may include granting protective orders in connection with discovery proceedings, holding in-camera hearings, sealing the records of the action, and ordering any person involved in the litigation not to disclose an alleged trade secret without prior court approval. Ind. Code § 24-2-3-6. A court may enter injunctive relief that is broader than a covenant not to compete if the court finds it necessary “to eliminate commercial advantage that otherwise would be derived from the misappropriation [of trade secrets].” *Ackerman v. Kimball Int’l*, 652 N.E.2d 507, 510 (Ind. 1995).

The IUTSA authorizes a court to permit future use of a trade secret upon payment of a royalty if circumstances would make the future use of the trade secret unreasonable. Ind. Code § 24-2-3-3(b). In Indiana, injunctions typically may not be issued if a party may be made whole through monetary damages. *Daugherty v. Allen*, 729 N.E.2d 228, 234-35 (Ind. Ct. App. 2000). There have been no Indiana appellate cases interpreting this provision, so it is unclear whether granting royalties in addition to injunctive relief would actually be permitted under Indiana law.

#### 4.3.2. Monetary Damages

Generally, a court may also issue monetary damages for a violation of the IUTSA where the court finds the aggrieved party has an adequate remedy at law. See Ind. Code § 24-2-3-4(a). The amount of the damages may constitute actual damages caused as well as any unjust enrichment damages arising out of the Misappropriation. *Id.* If the Misappropriation is found to be willful and malicious, then the court may award exemplary damages of up to twice the amount of calculated actual and unjust enrichment damages. Ind. Code § 24-2-3-4(c).

If the damages are not provable, the court may still enter a reasonable royalty for the period in which the trade secret could not have been used. Ind. Code § 24-2-3-4(b).

The monetary damages provision of the IUTSA also permits injunctive relief to run with monetary damages, Ind. Code § 24-2-3-4(a). There have been no cases interpreting this provision against the general principle that injunctive relief cannot issue if monetary damages may make the aggrieved party whole.

#### 4.3.3. Attorney's Fees

A party may seek attorney's fees if: 1) a misappropriation claim is made in bad faith; 2) a motion to terminate an injunction is made or resisted in bad faith; 3) if the misappropriation was willful and malicious. Ind. Code § 24-2-3-5.

### 4.4. Statute of Limitations

An action for misappropriation must be brought within three (3) years after the misappropriation is discovered or by the exercise of reasonable diligence should have been discovered. For the purposes of this section, a continuing misappropriation constitutes a single claim." Ind. Code § 24-2-3-7. When facts of the case present themselves, parties do have defenses to the three (3) year statute of limitations. See *Tecnomatic, S.P.A. v. Remy, Inc.*, 954 F. Supp. 2d 860, 865 (S.D. Ind. 2013).

### 4.5. Limited Disclosure of Trade Secrets in Discovery

A trade secret is potentially available for discovery, but the burden rests on the party-seeking discovery to show the secret is "relevant and necessary" to the litigation, and that the need for disclosure is determined proper through "substantial judicial discretion and careful attention to the facts of the particular case." *Bridgestone Ams. Holding, Inc. v. Mayberry*, 878 N.E.2d 189, 195-97 (Ind. 2007).

A court must preserve trade secret information by any reasonable means, including "granting protective orders in connection with discovery proceedings, holding in-camera hearings, sealing the records of the action, and ordering any person involved in the litigation not to disclose an alleged trade secret without prior court approval." Ind. Code § 24-2-3-6.

# Chapter 2: Fiduciary Duties (Close Corporations and LLCs)

## Introductory Note to Fiduciary Duty

Frank Sullivan, Jr.

A discussion of fiduciary duty best begins with perhaps the most famous case in corporate law, *Meinhard v. Salmon*, 164 N.E. 545 (N.Y. 1928), a decision of the New York Court of Appeals written by its Chief Judge, Benjamin N. Cardozo.

Salmon and Meinhard had signed a twenty-year lease to renovate a hotel property in New York City into commercial property. Salmon managed, sublet, and operated the property; Meinhard provided half of the capital in return for a split of the profits. The project was a great success and both became rich.

When the twenty-year lease term came to an end, the owner of the property entered into a new deal with Salmon alone. When Meinhard learned of the new deal, he asked for a share in it and when he was refused, he sued on the theory that the new lease was an asset of the original joint venture. Salmon responded that Meinhard had received the benefit of his bargain; at the outset of the transaction, Salmon and Meinhard agreed to be business partners for the twenty-year period of the lease – no more.

Cardozo's decision ordered Meinhard be provided a one-half interest in the new deal. He said that the nature of Salmon and Meinhard's relationship was "akin" to that of partners and, therefore, subject to the fiduciary duties of partners. Here is his famous quotation:

Joint adventurers, like copartners, owe to one another, while the enterprise continues, the duty of the finest loyalty. Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but *the punctilio of an honor the most sensitive*, is then the standard of behavior.

*Meinhard*, 164 N.E.at 546.

*Meinhard v. Salmon* sets the bar of fiduciary duty extremely high. That high bar has been adopted by the Indiana Supreme Court – unsurprisingly – as articulating the duty of the duty of bank trustees in dealing with their customers, *Malachowski v. Bank One, Indianapolis*, 590 N.E.2d 559, 567 (Ind. 1992); and adopted – quite robustly – as articulating the duty of the duty of majority shareholders in dealing with minority shareholders, *G & N Aircraft, Inc. v. Boehm*, 743 N.E.2d 227, 241 (Ind. 2001). The *Meinhard* standard has been adopted as well by the Indiana Court of Appeals as articulating the duty of partners to one another under the Indiana Uniform Partnership Act. *Boushehry v. Ishak*, 550 N.E.2d 784, 788 (Ind. Ct. App. 1990), modified, 560 N.E.2d 116. On the authority of *G & N Aircraft*, the Court of Appeals has held that common law fiduciary duties, similar to the ones imposed on partnerships and closely-held corporations, are applicable to Indiana LLCs. *Purcell v. S. Hills Investments, LLC*, 847 N.E.2d 991, 997 (Ind. Ct. App. 2006).



Other decisions included in the canon of Indiana fiduciary duty are *Hartung v. Architects Hartung/Odle/Burke, Inc.*, 301 N.E.2d 240, 243 (1973) (“shareholders in a close corporation, also referred to as an ‘incorporated partnership’, stand in a fiduciary relationship to each other”); *W & W Equip. Co. v. Mink*, 568 N.E.2d 564, 571 (Ind. Ct. App. 1991) (quoting the above language from *Hartung*); *Krukemeier v. Krukemeier Mach. & Tool Co.*, 551 N.E.2d 885, 887 (Ind. Ct. App. 1990) (same); *Barth v. Barth*, 659 N.E.2d 559, 561 (Ind. 1995) (same); and *Credentials Plus, LLC v. Calderone*, 230 F. Supp. 2d 890, 900, (N.D. Ind. 2002) (containing the language used above in *Purcell*’s holding).

*G&N Aircraft* is the lodestar when it comes to Indiana fiduciary duty law, in large part because of its separate treatment of the way its principles apply to “governing persons” and “business owners.” (“Governing persons” are directors in corporations; general partners in partnerships; managers in manager-managed LLCs; and members in member-managed LLCs. See Ind. Code § 23-0.5-1.5-15. “Business owners” are shareholders or stockholders in corporations; partners in partnerships; and members in LLCs.)

Governing persons owe the business entity a fiduciary duty of care which arises in two settings:

- Oversight: monitoring the activities of the managers and the general affairs of the business.
- Decision-making: making decisions that affect the business’s welfare.

Directors must act with absolute good faith and honesty in corporate dealings. *G & N Aircraft* 743 N.E.2d at 238 (citing *Schemmel v. Hill*, 169 N.E. 678, 682–83 (Ind. App. 1930)). However,

Indiana has statutorily implemented a strongly pro-management version of the business judgment rule. A director is not to be held liable for informed actions taken in good faith and in the exercise of honest judgment in the lawful and legitimate furtherance of corporate purposes. The rule includes a presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.

*G&N Aircraft* 743 N.E.2d at 238. By statute, negligence is insufficient to overcome the presumption; recklessness or willful misconduct is required. *Id.* (quoting Ind. Code § 23–1–35–1(e)). In *G & N Aircraft*, the justices unanimously said that “we think the judicially-crafted ‘business judgment rule’ operates to give broadest leeway to judgments that raise enterprise issues, if for no other reason than the self-interest of the directors/controllers is less directly involved.” *Id.* at 240.

Business owners are not protected by the business judgment rule in their dealings with each other. In addition to *Meinhard*’s “duty of the finest loyalty” formulation adopted in *G & N Aircraft*, the Indiana Supreme Court has also adopted Massachusetts’s strict fiduciary duty standard:

“Because of the fundamental resemblance of the close corporation to the partnership, the trust and confidence which are essential to this scale and manner of enterprise, and the inherent danger to minority interests in the close corporation, we hold that stockholders in the close corporation owe one another substantially the same fiduciary duty in the operation of the enterprise that partners owe to one another. In our previous decisions, we have defined the standard of duty owed by partners to one another as the ‘utmost good faith and loyalty.’ Stockholders in close

corporations must discharge their management and stockholder responsibilities in conformity with this strict good faith standard. They may not act out of avarice, expediency or self-interest in derogation of their duty of loyalty to the other stockholders and to the corporation."

*Barth* 659 N.E.2d at 561 n.6 (quoting *Donahue v. Rodd Electrotype Co. of New England, Inc.*, 328 N.E.2d 505, 515 (Mass. 1975) (footnotes and citations omitted)). (*G&N Aircraft* 743 N.E.2d at 240 also relies on Massachusetts authority).

The Indiana cases recite that a business owner "must deal fairly, honestly, and openly" with the business and fellow business owners and "must not be distracted from the performance of . . . official duties by personal interests." *G&N Aircraft* 743 N.E.2d at 240 (citing *Hartung* at 243). But as absolute as the duty is, its breach will depend upon the facts and circumstances of the case; "there must be a balance struck between the majority's fiduciary obligations and its rights." *G&N Aircraft* 743 N.E.2d at 240 (citing *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657, 663 (Mass. 1976)). *Wilkes* elaborates on this important point:

[T]he controlling group in a close corporation must have some room to maneuver in establishing the business policy of the corporation. It must have a large measure of discretion, for example, in declaring or withholding dividends, deciding whether to merge or consolidate, establishing the salaries of corporate officers, dismissing directors with or without cause, and hiring and firing corporate employees.

When an asserted business purpose for their action is advanced by the majority, however, we think it is open to minority stockholders to demonstrate that the same legitimate objective could have been achieved through an alternative course of action less harmful to the minority's interest. If called on to settle a dispute, our courts must weigh the legitimate business purpose, if any, against the practicability of a less harmful alternative.

*Wilkes* 353 N.E.2d at 663.

*G&N Aircraft* gives a good example of this. The defendant business owner Goldsmith initially had a minority interest in the corporation but as part of a plan to coerce the plaintiff Boehm to sell him his interest, Goldsmith purchased the shares of two other shareholders, reducing Boehm from a plurality to a minority position. While the purchase of shares of fellow minority shareholders would ordinarily be unobjectionable, the Court here found Goldsmith had breached his fiduciary duty to Boehm. "[T]he acquisitions leading to majority shareholder status were wrongs to Boehm because they were steps in a plan ultimately designed to use Goldsmith's position with G & N not for any proper business purpose of *G&N*, but rather to squeeze Boehm out." *G&N Aircraft* 743 N.E.2d at 242.

As to remedies, *G&N Aircraft* holds that they are broadly remedial:

[T]raditional powers of equity courts are available to fashion a remedy for breach of a fiduciary duty in a close corporation. We also agree with the courts that have recognized the need for more flexible remedies in the case of close corporations. Unlike shareholders in a publicly traded corporation, the oppressed minority in a

close corporation does not have the option of voting with its feet by selling its shares in a public market for a presumptively fair price.

*Id.* at 244.

## 1. Who Owes the Duty?

### 1.1. In the context of Close Corporations:

- 1) Officers;
- 2) Directors; and
- 3) Voting Shareholders (both majority and minority).

*Barth v. Barth*, 659 N.E.2d 559, fn. 6 (Ind. 1995); *Donahue*, 328 N.E.2d at n. 17.

\*Notably, no duty arises solely from ownership of non-voting stock. *First of Am. Bank, N.A. v. Norwest Bank, Ind., N.A.*, 765 N.E.2d 149, 151-52 (Ind. Ct. App. 2002).

### 1.2 In the context of LLCs:

- 1) Managers; and
- 2) Members.

Indiana Code § 23-18-6-6.1 provides, “unless otherwise provided in a written operating agreement, a member may not withdraw from a limited liability company before the dissolution and winding up of the limited liability company.”

In a manager-managed LLC, unless otherwise provided in the operating agreement, a non-managing member “has no duties to the LLC or to the other members solely by reason of acting in the capacity as a member.” Ind. Code § 23-18-4-2(c)[emphasis added].

This statutory provision remains un-interpreted by case law. However, this section is based upon the 1992 ABA Prototype LLC Act § 402 (“Prototype Act”). The Official Comment to Prototype Act § 402 provides in part:

“Subsection (C) makes clear that members who do not act as managers, like corporate shareholders and limited partners, do not have the fiduciary duties of managers described in this Act. However, they may have fiduciary duties if they engage in control transactions or act in some capacity other than merely as a member. See *Donahue v. Rodd Electrotpe Co. of New England, Inc.*, 329 N.E.2d 505 (Mass. 1975) (liability of controlling shareholder in close corporation). Moreover, even if a member is not involved in management, the member has no right to appropriate for personal use property belonging

to the LLC. See *Tri-Growth Centre City, Ltd. v. Silldorf*, 265 Cal. Rptr. 330 (Cal App. 1989). In addition, members, like other contracted parties, must exercise their powers in good faith. For example, it may be bad faith to expel a member solely or primarily in order to appropriate the value of the member's interest. In general, while the [Prototype Act Drafting] Committee believes that some type of "partner-like" duties should be imposed upon non-managing members, it concluded that the exact nature of those duties and whether they should be applied to all members or only managing members is an are best left to the courts."

The Official Comments to the Prototype Act have not be adopted in Indiana. In fact, there are no Official Comments to the Indiana LLC Act, although the Indiana Business Law Survey Commission has a draft set of Official Comments under consideration.

## 2. To Whom is the Duty Owed?

### 1.1 In the context of Close Corporations:

- 1) The Corporation (*Barth v. Barth*, 659 N.E.2d 559, 561 (Ind. 1995); and
- 2) ALL its shareholders (both majority and minority, voting and non-voting). *Id.*

### 1.2 In the context of LLCs:

- 1) The Company (if acting as an officer or manager); and
- 2) ALL its members (both majority and minority, managing and non-managing). *Rapkin Grp., Inc. v. Cardinal Ventures, Inc.*, 29 N.E.3d 752, 760 (Ind. Ct. App. 2015).

\*Notably, "Indiana does not extend the fiduciary duties of directors and officers to the corporation's creditors." *Geiger & Peters, Inc. v. Berghoff*, 854 N.E.2d 842, 851 (Ind. Ct. App. 2006).

## 3. Who can Bring a Cause of Action?

### 3.2 For a derivative action:

- 3.2.1 The general rule is the corporation must bring a cause of action on behalf of all its shareholders unless demand is excused because of futility: "To excuse demand [because of 'futility'], a court must determine whether the particularized factual allegations create a reasonable doubt that the board could have properly exercised disinterested business judgment in responding to a demand." *Piven v. ITT Corp. (In re ITT Derivative Litig.)*, 932 N.E.2d 664, 668 (Ind. 2010); *Rales v. Blasband*, 634 A.2d 927 (Del. 1993). "A director is 'interested' for demand futility purposes if a derivative claim poses a significant risk of personal liability for the director. Being deemed 'interested'

requires more than a 'mere threat' of personal liability--there must be 'a substantial likelihood' of liability for the director." *Priven*, 932 N.E.2d at 668. And by statute, even where a majority of the board are "interested" persons, "[t]he availability of [a] disinterested committee will bar a separate derivative action unless the derivative plaintiff can establish that the committee was not disinterested or that its decision was not undertaken after a good faith investigation." *Ritter v. Dollens (In re Guidant S'holders Derivative Litig.)*, 841 N.E.2d 571, 576 (Ind. 2006).

- 3.2.2 Notwithstanding, the *Barth* exception "exempt[s] the [shareholder of a close corporation] from the requirements of Ind. Code § 23-1-32-1 *et seq.*, including the provisions that permit a special committee of the board of directors to recommend dismissal of the lawsuit," and grants the trial court the discretion to allow an individual shareholder to bring a claim which would otherwise be derivative, directly, if it finds that to do so will not:
- a. unfairly expose the corporation or the defendants to a multiplicity of actions;
  - b. materially prejudice the interests of creditors of the corporation; or
  - c. interfere with a fair distribution of the recovery among all interested persons. *Barth v. Barth*, 659 N.E.2d 559, 562 (Ind. 1995).

\*Under the *Barth* exception, "the court in making its decision should [still] consider whether the corporation has a disinterested board that should be permitted to consider the lawsuit's impact on the corporation." *Id.*

### 3.3 For a direct action:

- 3.3.1 "A direct action may be brought when . . . it is based upon a primary or personal right belonging to the plaintiff shareholder." *G & N Aircraft, Inc. v. Boehm*, 743 N.E.2d 227, 234-235 (Ind. 2001); *See also, Barth v. Barth*, 659 N.E.2d 559, n.4 (Ind. 1995).

**\*Practice Tip:** *G & N Aircraft, Inc.* discusses the difference between a direct and a derivative action, *G & N Aircraft, Inc.*, 743 N.E.2d at 234-35, but it is still unclear after *G & N Aircraft, Inc.* how liberally breach of fiduciary duty claims can be classified as "direct actions."<sup>2</sup> As such, best practice would be for the

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<sup>2</sup> Compare, *Purcell*, 847 N.E.2d at 1001 (holding the breach of fiduciary duty for self-dealing claim was a direct action, and thus concluding, "we do not need to investigate whether the *Barth* exception is applicable"), with *Marcuccilli*, 766 N.E.2d 444 (holding the breach of fiduciary duty for self-dealing claims were derivative, not direct, and further holding the trial court did not abuse its discretion by not allowing the derivative actions to proceed directly). *See also, Gebaur, John, Action in Own Name by Shareholder of Closely Held Corporation*, 10 A.L.R.6th 293 (surveying the different approaches jurisdictions are taking as they wrestle with this complicated issue).

trial court to conduct a *Barth* exception analysis, holding an evidentiary hearing if necessary. See *Kesling v. Kesling*, 83 N.E.3d 111, 113 (Ind. Ct. App. 2017).

\*\*Similar *Barth* exception rules apply in the context of LLCs. *Purcell v. S. Hills Invs., LLC*, 847 N.E.2d 991, 1001 (Ind. Ct. App. 2006).

## 4. What is the Duty?

In general, the leading case on fiduciary duty is *Meinhard v. Salmon*, 164 N.E. 545 (N.Y. 1928). Which contains this famous passage written by Judge (later Chief Judge and later still Justice) Cardozo:

Joint adventurers, like copartners, owe to one another, while the enterprise continues, the duty of the finest loyalty. Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior.

This formulation has been adopted by the Indiana Supreme Court as articulating the duty of majority shareholders in dealing with minority shareholders, *G & N Aircraft, Inc. v. Boehm*, 743 N.E.2d 227 (Ind. 2001); and the duty of bank trustees in dealing with their customers, *Malachowski v. Bank One, Indianapolis*, 590 N.E.2d 559 (Ind. 1992). It has been adopted as well by the Indiana Court of Appeals as articulating the duty of partners to one another under the Indiana Uniform Partnership Act. *Boushehry v. Ishak*, 550 N.E.2d 784, 788 (Ind. Ct. App.).

Indiana courts have characterized closely-held corporations as "incorporated partnerships" and as such have imposed a fiduciary duty upon shareholding "partners" to deal fairly not only with the corporation but with fellow shareholders as well. See *Krukemeier v. Krukemeier Mach. & Tool, Co.*, 551 N.E.2d 885, 888 (Ind. Ct. App. 1990); *Ross v. Tavel*, 418 N.E.2d 297, 304 (Ind. Ct. App. 1981); *Motor Dispatch, Inc. v. Buggie*, 379 N.E.2d 543, 547 (Ind. Ct. App. 1978); *Cressy*, 378 N.E.2d at 945; *Hartung v. Architects Hartung/Odle/Burke, Inc.*, 301 N.E.2d 240, 243 (Ind. Ct. App. 1973). As a result, we have held that "shareholders in a close corporation stand in a fiduciary relationship to each other, and as such, must deal fairly, honestly, and openly with the corporation and with their fellow shareholders." *Barth*, 659 N.E.2d at 561. *Accord Fleming v. Intl. Pizza Supply*, 676 N.E.2d 1051, 1056 (Ind.1997) (citations omitted); *Krukemeier*, 551 N.E.2d at 888; *Dotlich v. Dotlich*, 475 N.E.2d 331, 341 (Ind. Ct. App. 1985); *Hartung*, 301 N.E.2d at 243.

*Melrose v. Capitol City Motor Lodge, Inc.*, 705 N.E.2d 985, 991 (Ind. 1998).

Fiduciary duties are generally sub-divided into a duty of loyalty, a duty of care, and a duty of good faith. Ind. Code § 23-1-35-1, cmt. to subsection (e). "The standard of conduct under the duty of loyalty essentially requires a manager to act fairly when he acts in his own pecuniary self-interest or in the pecuniary interest of an associate or a family member." Melvin A. Eisenberg, *The Duty of Good Faith in Corporate Law*, 31 Del. J. Corp. L. 1, 5 (2006), available at: <http://scholarship.law.berkeley.edu/facpubs/737>. "The standard of conduct under the duty of care essentially requires a manager, when not acting in his own self-interest, to perform his duties in a manner that he reasonably believes to be in the best interests of the corporation . . ." *Id.* And the duty of good faith essentially acts as a "catch-all" for those instances where the fiduciary fails to deal **fairly, honestly, and openly** with his corporation and fellow stockholders, "but that cannot be easily accommodated within the duties of care and loyalty." *Id.* at 6.

\*The following is meant to be illustrative, and is not an exhaustive list of all the ways the duty to deal **fairly, honestly, and openly** can be breached.

## 4.2 Duty of Loyalty

Corporate fiduciaries "may not act out of avarice, expediency or self-interest in derogation of their *duty of loyalty* to the other stockholders and to the corporation." *Barth v. Barth*, 659 N.E.2d 559, fn. 6 (Ind. 1995) (emphasis added).

### 4.2.1 Self-Dealing

Corporate fiduciaries "must not in any degree allow their official conduct to be swayed by their private interest which must yield to official duty." *Hartung v. Architects Hartung/Odle/Burke, Inc.*, 301 N.E.2d 240, 240 (Ind. Ct. App. 1973). "General public policy prevents a person from deriving a[n] [undue] benefit to himself or working a wrong to another through a fiduciary relationship existing between the parties." *Id.* at 244.

"[T]he law approaches transactions between a corporation and those in a position to control its acts with 'a large measure of watchful eye.' . . . [I]f it appears that honoring the claim will work an injustice, subordination or disallowance of the claim may be required." *Purcell v. S. Hills Invs., LLC*, 847 N.E.2d 991, 1000 (Ind. Ct. App. 2006).

"Put simply, it is a breach of the . . . shareholder's fiduciary duty to cause the corporation to enter into an unfair transaction to the personal advantage of the . . . shareholder." *G & N Aircraft, Inc. v. Boehm*, 743 N.E.2d 227, 239 (Ind. 2001).

#### 4.2.2 Usurpation of Corporate Opportunity

"[A] corporate fiduciary may not appropriate to his own use a business opportunity that in equity and fairness belongs to the corporation. The particular facts and circumstances of each case must be examined to determine if the opportunity belonged to the corporation or if it is one personal to the individual." *Hartung*, 301 N.E.2d at 244. Specifically:

"If there is presented to a corporate officer or director a business opportunity which the corporation is financially able to undertake, is, from its nature, in the line of the corporation's business and is of practical advantage to it, is one in which the corporation has an interest or a reasonable expectancy, and, by embracing the opportunity, the self-interest of the officer or director will be brought into conflict with that of his corporation, the law will not permit him to seize the opportunity for himself. And, if, in such circumstances, the interests of the corporation are betrayed, the corporation may elect to claim all the benefits of the transaction for itself, and the law will impress a trust in favor of the corporation upon the property, interests and profits so acquired." *McLinden v. Coco*, 765 N.E.2d 606, 616 (Ind. Ct. App. 2002); *Kirtley v. McClelland*, 562 N.E.2d 27, 33 (Ind. Ct. App. 1990).

"The general rule is that the fiduciary cannot lure away corporate business or clients which in equity and fairness belongs to his corporation." *Hartung v. Architects Hartung/Odle/Burke, Inc.*, 157 Ind. App. 546, 556 (Ind. Ct. App. 1973).

"Fiduciaries have been found in breach of their duty for luring away corporate personnel." *Id.* at 557.

\*Generally, the remedy for breach of the duty of loyalty is the disgorgement of ill-gotten gains. See *McLinden v. Coco*, 765 N.E.2d 606, 616 (Ind. Ct. App. 2002) ("Southwick Homes, however, is entitled only to those profits Mutual Development acquired in the development of the subdivision up to and including the finished lots. . . Southwick Homes is entitled to the profits from these fees--but not to the entire fees themselves."). See also, *Kirtley*, 562 N.E.2d at 33 (noting that "the law will impress a trust in favor of the corporation upon the property, interests and profits so acquired"). But Indiana has not foreclosed the possibility that the underlying breach of fiduciary duty might give rise to other damages. See *Valeant Pharms. Int'l v. Jerney*, 921 A.2d 732, 752 (Del. Ch. 2007) ("[T]here are two distinct sources for an award of damages in the case of an unfair self-dealing transaction. First, such a transaction is voidable as between



the parties to the transaction. Second, the underlying breach of the fiduciary duty of loyalty may give rise to other damages”).

- 4.2.3 *Melrose v. Capitol City Motor Lodge, Inc.*, 705 N.E.2d 985 (Ind. 1998). After a closely held corporation decided to liquidate, Smulyan, a director-shareholder, sought to purchase corporate-owned insurance policies on his life for their cash surrender value. Melrose, another director-shareholder, objected on grounds that Smulyan’s life expectancy made the policies far more valuable than their cash surrender value.

Indiana Business Corporation Law [Ind. Code § 23–1–35–2 (1993)] defines a conflict of interest transaction as follows: (a) A conflict of interest transaction is a transaction with the corporation in which a director of the corporation has a direct or indirect interest. A conflict of interest transaction is not voidable by the corporation solely because of the directors interest in the transaction if any one (1) of the following is true: (1) The material facts of the transaction and the director's interest were disclosed or known to the board of directors or a committee of the board of directors and the board of directors or committee authorized, approved, or ratified the transaction. (2) The material facts of the transaction and the director's interest were disclosed or known to the shareholders entitled to vote and they authorized, approved, or ratified the transaction. (3) The transaction was fair to the corporation.

Because (1) the material facts of the transaction and Smulyan's interest were disclosed or known to Melrose, (2) the requisite corporate formalities necessary to authorize, approve or ratify the transaction were followed, and (3) the transaction was fair to the corporation, the requirements of the Business Corporation Law and the common law of fiduciary duty were satisfied and summary judgment in favor of Smulyan was properly granted.

## 4.3 Duty of Care.

### 4.3.1 Business Judgment Rule

Corporations

“A director shall, based on facts then known to the director, discharge the duties as a director . . . :

- (1) in good faith;
- (2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and
- (3) in a manner the [fiduciary] reasonably believes to be in the best interests of the corporation.” Ind. Code § 23-1-35-1(a).

The courts have placed some gloss on this “business judgment rule.” “[A] [corporate fiduciary] cannot blindly take action and later avoid the consequences by saying he was not aware of the effect of the action he took. A [fiduciary] has some duty to become informed about the actions he is about to undertake.” *W & W Equipment Co. v. Mink*, 568 N.E.2d 564, 575 (Ind. Ct. App. 1991). “To avoid liability ‘it is incumbent upon a corporate [fiduciary], on learning facts sufficient to put a prudent man on guard, to take the appropriate action under the circumstances.” *Dotlich v. Dotlich*, 475 N.E.2d 331, 343 (Ind. Ct. App. 1985).

However, “A director is not liable for any action taken as a director, or any failure to take any action, regardless of the nature of the alleged breach of duty, including alleged breaches of the duty of care, the duty of loyalty, and the duty of good faith, unless: (1) the director has breached or failed to perform the duties of the director’s office in compliance with this section; and (2) the breach or failure to perform constitutes willful misconduct or recklessness.” Ind. Code § 23-1-35-1(e).

Other subsections of Ind. Code 23-1-35-1 set forth additional protections and duties for directors. The general thrust of these provisions demonstrate legislative intent to “implement[ ] a strongly pro-management version of the business judgment rule. *G & N Aircraft, Inc. v. Boehm*, 743 N.E.2d 227, 238 (Ind. 2001).

#### Limited Liability Companies

“Unless otherwise provided in the operating agreement, a member or manager is not liable for damages to the LLC or to the members of the LLC for any action taken or failure to act on behalf of the LLC, unless the act or omission constitutes willful misconduct or recklessness.” Ind. Code § 23-18-4-2(a).

Ind. Code § 23-18-4-2(a) has been applied as setting forth the duty of loyalty of managers and members of LLCs. See *Purcell v. S. Hills Investments, LLC*, 847 N.E.2d 991, 999 (Ind. Ct. App. 2006). It is better understood as setting forth the duty of care. This section is based upon the 1992 ABA Prototype LLC Act § 402 (“Prototype Act”). The Official Comment to Prototype Act § 402 provides in part:

“Subsection (A) sets forth the gross negligence standard of care for those participating in management. This is similar to the standard commonly applied to corporate directors, managing partners, or general partners of limited partnerships. In general, as long as managers avoid self-interested and grossly negligent conduct, their actions are protected by the business judgment rule.”

The Official Comments to the Prototype Act have not been adopted in Indiana. In fact, there are no Official Comments to the Indiana LLC Act, although the Indiana Business Law Survey Commission has a draft set of Official Comments under consideration.

"A member or manager of a limited liability company is not liable when relying in good faith upon the records of the limited liability company and on the information, opinions, reports, or statements presented to the limited liability company by its other managers, members, agents, or employees, or by any other person, concerning matters the member or manager reasonably believes are within the other person's professional or expert competence and who has been selected with reasonable care by or on behalf of the limited liability company, including information, opinions, reports, or statements concerning the value and amount of the assets, liabilities, profits, or losses of the limited liability company or other facts pertinent to the existence and amount of assets from which distributions to members might properly be paid." Ind. Code § 23-18-4-10

#### 4.3.2 Duty to Disclose

The Indiana Court of Appeals has found that corporate fiduciaries have a duty to disclose pertinent information: "The duty to disclose stems from the necessity of preventing a corporate insider from utilizing his position to take unfair advantage of the uninformed . . . stockholders." *Lowry v. Lowry*, 590 N.E.2d 612, 620 (Ind. Ct. App. 1992).

##### 4.3.2.1 Duty to Disclose Misdeeds of Others

Although "a director is not [ordinarily] liable for the misconduct of a co-director, . . . a director is liable if he learns of a co-director's misdeeds and either takes no action or acquiesces therein. The director is under a duty to disclose the misconduct of a co-director to the other directors in order to avoid liability for acquiescence." *Dotlich v. Dotlich*, 475 N.E.2d 331, 343 (Ind. Ct. App. 1985).

#### 4.3.3 Duty to Monitor

Corporate fiduciaries have a "duty to monitor corporate employees." *Piven v. ITT Corp. (In re ITT Derivative Litig.)*, 932 N.E.2d 664, 668 (Ind. 2010).

\*Specialized standard of proof: "To impose liability [upon directors] for a failure in monitoring, the claimant must demonstrate that the directors made a conscious decision to breach their duty of care and also show that the directors acted in bad faith." *Id.; Desimone v. Barrows*, 924 A.2d 908, 935 (Del. Ch. 2007).

#### 4.3.4 Corporate Waste

Corporate fiduciaries have a duty to avoid corporate waste. *G & N Aircraft, Inc. v. Boehm*, 743 N.E.2d 227, 239 (Ind. 2001).

\*Specialized standard of proof: "The standard of proof in compensation cases requires a plaintiff shareholder to show the compensation is *unjust, oppressive, or fraudulent.*" *Id.*

#### 4.3.5 Unlawful Corporate Distributions

Corporate fiduciaries can be held liable for making unlawful distributions. *Designplan, Inc. v. Price*, 980 N.E.2d 926 (Ind. Ct. App. 2013).

### 4.4 Duty of Good Faith

#### 4.4.1 "Squeeze-outs" (a.k.a. "freeze-outs")

"[C]ontrolling shareholders must 'observe accepted standards of business ethics in transactions affecting rights of minority shareholders,' and apply a 'strict good faith standard.'" *G & N Aircraft, Inc. v. Boehm*, 743 N.E.2d 227, 240 (Ind. 2001). Generally speaking, a "squeeze-out" rises to the level of a fiduciary duty when the majority infringes upon the interests and reasonable expectations of the minority for no legitimate business purpose.<sup>3</sup> Most commonly, shareholders assert "squeeze-out" claims to protect their ownership interest, voting power, or reasonable expectation to draw a salary. *W & W Equipment Co. v. Mink*, 568 N.E.2d 564, 574 (Ind. Ct. App. 1991); *G & N Aircraft, Inc. v. Boehm*, 743 N.E.2d 227, 242 (Ind. 2001).

"However, as one court cautioned, there must be a balance struck between the majority's fiduciary obligations and its rights, [as] it is also the policy of the law to leave corporate affairs to the control of corporate agencies 'except in a plain case of fraud, breach of trust, or such maladministration as works a manifest wrong to [the shareholders].'" *G & N Aircraft, Inc. v. Boehm*, 743 N.E.2d 227, 240-41 (Ind. 2001); *W & W Equip. Co. v. Mink*, 568 N.E.2d 564, 575 (Ind. Ct. App. 1991).

\*Caution: "Squeeze-outs" effectuated through a merger or asset sale receive special treatment. *See Fleming v. International Pizza Supply Corp.*, 676 N.E.2d 1051, 1056-57 (Ind. 1997) (recognizing "in a merger or asset sale, the exclusive remedy available to a shareholder seeking payment for the value of the shareholder's shares is the statutory appraisal procedure," but ultimately holding the common-law breach of fiduciary duty claims could be litigated within said statutory appraisal procedure). *See also, G & N Aircraft, Inc. v. Boehm*, 743 N.E.2d 227, 243 (Ind. 2001) (holding *Fleming* had no applicability in that "squeeze-out" action because no merger or asset sale occurred).

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<sup>3</sup> In some jurisdictions (unanswered for Indiana), "even if the majority can advance an ostensible business purpose, the minority [has] the opportunity to show that 'the same legitimate [business] objective could have been achieved through an alternative course of action less harmful to the minority's interest.'" Murdock, Charles W., *The Evolution of Effective Remedies for Minority Shareholders and its Impact upon Valuation of Minority Shares*, 65 NOTRE DAME L. REV. 425, 436 (1990).

## 5. Defenses

### 5.2 “Business Judgment Rule” Defense<sup>4</sup>

- 5.2.1 Statutorily-implemented version of the business judgment rule for directors of close corporations:

“Indiana has statutorily implemented a strongly pro-management version of the business judgment rule” which only applies to directors; it does not apply to officers or shareholders in the exercise of their own discretionary authority. *G & N Aircraft, Inc. v. Boehm*, 743 N.E.2d 227, 238 (Ind. 2001) (applying the statutorily implemented business judgment rule, Ind. Code § 23-1-35-1, to Boehm’s derivative claims that the board-approved actions breached the fiduciary duties owed to the corporation but not applying the rule to Boehm’s direct claims against Goldsmith as a shareholder). *See also*, the official study commissions commentary to Ind. Code § 23-1-36-2. “The exculpation afforded to directors under [the statutorily implemented rule] applies to alleged breaches of the duty of care, the duty of loyalty, and the duty of good faith . . .” Ind. Code § 23-1-35-1, cmt. to subsection (e).

Under the statutorily implemented rule, “[a] director is not to be held liable for informed actions taken in good faith and in the exercise of honest judgment in the lawful and legitimate furtherance of corporate purposes. The rule includes ‘a presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.’” *G & N Aircraft, Inc.*, 743 N.E.2d at 238.

“The burden is on the party challenging the decision to establish facts rebutting the presumption.” *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984); *G & N Aircraft, Inc.*, 743 N.E.2d at 238. By statute, negligence is insufficient to overcome the presumption; recklessness or willful misconduct is required.” *G & N Aircraft, Inc.*, 743 N.E.2d at 238(emphasis added); Ind. Code § 23-1-35-1. “The official study commission comment on Indiana’s business judgment rule statute states that director liability for damages requires proof of, ‘at a minimum, conscious disregard of or indifference to the consequences of a risky act.’” *Marwil v. Grubbs*, 2004 U.S. Dist. LEXIS 20250, \*31 (S.D. Ind. Sept. 30, 2004). In *Purcell*, the Court of Appeals expounded:

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<sup>4</sup> The BJR is not a defense to all claims of breach of fiduciary duty but only a claim of breach of the fiduciary duty of care. *G & N Aircraft* is perhaps the best case in the country on this: Goldsmith’s actions as director were protected by the BJR but his actions as shareholder were not.

[A] willful and wanton act of commission is: an intentional act done with the reckless disregard of the natural and probable consequence of injury to a known person under the circumstances known to the other actor at the time. . . . [A] willful and wanton omission as a failure to act when the actor has actual knowledge of the natural and probable consequence of injury and his opportunity to avoid the risk. "Whether the party has acted or failed to act, willful and wanton misconduct has two elements: 1) the defendant must have knowledge of an impending danger or consciousness of a course of misconduct calculated to result in probable injury; and 2) the actor's conduct must have exhibited an indifference to the consequences of his own conduct." *Purcell v. S. Hills Invs., LLC*, 847 N.E.2d 991, 999 (Ind. Ct. App. 2006).

*Note:* Some commentators are critical of *Purcell*, particularly the passage which quotes from an auto accident case in defining "willful and wanton act of commission." *Purcell* might be citing the wrong statute here. A member's liability in this context might more properly be defined in § 23-18-3-3(a), not § 23-18-4-2(a).

Notwithstanding, "a director cannot blindly take action and later avoid the consequences by saying he was not aware of the effect of the action he took. A director has some duty to become informed about the actions he is about to undertake" and, thus, can be held liable when his failure to become informed constitutes a willful and wanton omission. *W & W Equipment Co. v. Mink*, 568 N.E.2d 564, 575 (Ind. Ct. App. 1991). Nevertheless, Indiana Code § 23-2-35-1 clarifies that directors are "entitled to rely on information, opinions, reports, or statements, including financial statements and other financial data [prepared or presented by certain enumerated persons]. . .", provided the director does not have "knowledge concerning the matter in question that makes [said] reliance . . . unwarranted." And the rule further "allows directors the full discretion to weigh [a variety of enumerated] factors . . . as they deem appropriate." Indiana Code § 23-1-35-1 (b), (c), (d), and (f)(1).

#### 5.2.1.1 Unanswered Question – Shifting of Presumptions/Burden of Proof

Under the common law, the presumption was that "directors of a corporation acted . . . in the best interests of the company" and it was the plaintiff's burden to overcome that presumption. *G & N Aircraft, Inc.*, 743 N.E.2d at 238; *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984). However, under the common law, that presumption was overcome "once it [was] established that one with a fiduciary duty [had] attempted to benefit from a questioned transaction, [because] the law presume[d] fraud.' The burden of

proof then shift[ed] to the fiduciary to overcome the presumption [of fraud] by showing his actions were honest and in good faith." *W & W Equipment Co.*, 568 N.E.2d at 576; *Dotlich*, 475 N.E.2d at 342.

So too, under the statutorily-implemented rule, the presumption is that "directors of a corporation acted . . . in the best interests of the company" and it is the plaintiff's burden to overcome that presumption. The unanswered question is whether, under the statutorily-implemented rule, that initial presumption is still overcome "once it is established that one with a fiduciary duty has attempted to benefit from a questioned transaction, [because] the law presumes fraud [i.e., the law presumes intentional misconduct].' [And whether] the burden of proof [still] shifts to the fiduciary to overcome the presumption [of fraud/intentional misconduct] by showing his actions were honest and in good faith [or, alternatively, not the result of intentional misconduct or recklessness]." *W & W Equipment Co. v. Mink*, 568 N.E.2d 564 (Ind. Ct. App. 1991).

#### 5.2.1.2 Specialized Standards of Proof

"To impose liability [upon directors] for a failure in monitoring, the claimant must demonstrate that the directors made a conscious decision to breach their duty of care and also show that the directors acted in bad faith." *Piven v. ITT Corp. (In re ITT Derivative Litig.)*, 932 N.E.2d 664, 668 (Ind. 2010); *Desimone v. Barrows*, 924 A.2d 908, 935 (Del. Ch. 2007).

"The standard of proof in compensation cases requires a plaintiff shareholder to show the compensation is unjust, oppressive, or fraudulent." *G & N Aircraft, Inc. v. Boehm*, 743 N.E.2d 227, 239 (Ind. 2001); *Krukemeier v. Krukemeier Mach. & Tool Co.*, 551 N.E.2d 885, 888 (Ind. Ct. App. 1990).

#### 5.2.2 Statutorily implemented rules for managers and members of LLCs: *[Note from FSJ: You will recognize that I have added some of this material to my BJR definitional section above. Not sure which is the better place for it.]*

Ind. Code § 23-18-4-2 provides:

- (a) "Unless otherwise provided in the operating agreement, a member or manager is not liable for damages . . . for any action

taken or failure to act on behalf of the LLC, unless the act or omission constitutes willful misconduct or recklessness.”<sup>5</sup>

(b) Unless otherwise provided in a written operating agreement, each member and manager must account to the LLC and hold as trustee for it any profit or benefit derived by the manager or member without the consent of a majority of the disinterested managers or members or other persons participating in the management of the business or affairs of the limited liability company from:

- (1) A transaction connected with the conduct or winding up of the limited liability company; or
- (2) Any use by the manager or member of the limited liability company’s property, including confidential or proprietary information of the limited liability company or other matters entrusted to the manager or member because of the manager’s or member’s status as manager or member.<sup>6</sup>

(c) Unless otherwise provided in a written operating agreement, a member of a limited liability company in which the articles of organization provide for a manager or managers and who is not a manager has no duties to the limited liability company or to the other members solely by reason of acting in the capacity as a member.<sup>7</sup>

Ind. Code § 23-18-4-10 provides:

“A member or manager of a limited liability company is not liable when relying in good faith<sup>8</sup> upon the records of the limited liability company and on the information, opinions, reports, or statements presented to the limited liability company by its other managers, members, agents, or employees, or by any other person, concerning matters the member or manager reasonably believes are within the other person’s

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<sup>5</sup> Subsection (a) is in derogation of the common-law and implements Indiana’s strongly pro-management version of the business judgment rule when a member or manager is acting on behalf of the LLC. *See Supra*, V(A)(1).

<sup>6</sup> Subsection (b) is a codification of the common-law rule that when a fiduciary profits or benefits from a questioned transaction “the law will impress a trust in favor of the corporation upon the property, interests and profits so acquired.” *Kirtley v. McClelland*, 562 N.E.2d 27, 33 (Ind. Ct. App. 1990).

<sup>7</sup> Subsection(c) is in derogation of common-law, and has yet to be interpreted.

<sup>8</sup> Borrowing from corporate law, a member or manager is not “relying in good faith” “if the [member or manager] has knowledge concerning the matter in question that makes reliance otherwise permitted . . . unwarranted.” Ind. Code § 23-1-35-1.



professional or expert competence and who has been selected with reasonable care by or on behalf of the limited liability company, including information, opinions, reports, or statements concerning the value and amount of the assets, liabilities, profits, or losses of the limited liability company or other facts pertinent to the existence and amount of assets from which distributions to members might properly be paid.”

\* The same unanswered question – shifting of presumption/burden of proof – exists. *Supra*, V(A)(1)(i).

\*\* The same specialized standards of proof are likely to apply. *Supra*, V(A)(1)(ii).

## 5.3 The “‘Modification’ or ‘Waiver’ of Fiduciary Duties” Defense

### 5.3.1 In the context of Close Corporations:

Indiana case law is unclear if it is allowable for articles of incorporation to provide additional exculpation for directors and officers. Indiana Code § 23-1-21-2 does not explicitly state the articles of incorporation may include a modification or waiver provision (as Delaware’s statute does).

### 5.3.2 In the context of LLCs

“A written operating agreement may . . . [m]odify, increase, decrease, limit, or eliminate the duties (including fiduciary duties) or the liability of a member or manager for breach of the duties . . .” Ind. Code § 23-18-4-4(a)(1). But, “[w]hile it is true that LLC members and managers may modify or negate their fiduciary duties, we can only conclude that those duties are so fundamental and paramount to the smooth operation of companies that any modification or negation of fiduciary duties must be explicit.” *Joshi v. Apollo Med. Grp., LLC*, No. 82A01-1612-CT-2842, Lexis (Ind. Ct. App. Oct. 5, 2017); *See also, Miller v. Am. Real Estate Partners, L.P.*, 2001 Del. Ch. Lexis 116, \*1-2 (Del. Ch. 2001) (“This is yet another case in which a general partner of a limited partnership contends that the partnership agreement eliminates the applicability of default principles of fiduciary duty, and in which this court finds that the drafters of the agreement did not make their intent to eliminate such duties sufficiently clear to bar a fiduciary duty claim.”).

Here is an article on this most interesting topic: James D. Johnson & Spencer W. Tanner, *Specific, Explicit, Unambiguous Modification of Fiduciary Duties in*

Limited Liability Companies, 13 No. 3 In-House Def. Q. 32 at 4 (2018), available at:

[Specific, Explicit, Unambiguous: Modification of Fiduciary Duties in Limited Liability Companies In-House Defense Quarterly : Summer 2018 \(onlinedigitalpublishing.com\)](#).<sup>9</sup>

## 5.4 The “Completely ‘Frozen-out’ Shareholder” Defense:

Whether a shareholder’s “frozen-out” status terminates the fiduciary duty is an unanswered question of Indiana law.

At least two jurisdictions have held that a shareholder’s “frozen-out” status does terminate the fiduciary duty. *J Bar H, Inc. v. Johnson*, 822 P.2d 849, 861 (Wyo. 1991); *Advanced Commun. Design, Inc. v. Follett*, 615 N.W.2d 285, 294 (Minn. 2000) (holding that resignation ends the fiduciary duty when there is no voting stock) (and also see the subsequent, unpublished opinion, *Piche v. Braaten*, A13-0534, Lexis \*16 (Minn. Ct. App. Feb. 3, 2014) (holding a former employee’s fiduciary duty ended when his employment was terminated even though he was a minority shareholder of voting stock, because he was “frozen-out” as a matter of law)).

And at least two jurisdictions have held that a shareholder’s “frozen-out” status does NOT terminate the fiduciary duty. *Selmark Assocs. v. Ehrlich*, 467 Mass. 525, 539 (Mass. 2014); *Root Consulting, Inc. v. Insull*, 2016 U.S. Dist. LEXIS 26229, \*13-14 (N.D. Ill. 2016) (person was terminated, but maintained working as the VP, which allowed fiduciary duty to still exist).

Often times, parties improperly try to invoke this defense because they are allegedly *in the process of being “frozen-out,”* also known as a “squeeze-out.”<sup>10</sup> However, the policy by other states behind the termination of fiduciary duties for “frozen-out” shareholders is because they can no longer exercise any control over the corporation; therefore, for a shareholder’s “frozen-out” status to terminate the fiduciary duty, that shareholder must be “completely frozen-out.” In Indiana, a shareholder is “completely frozen-out” when he is completely eliminated from the enterprise and his remaining voting power and claims on corporate assets is relatively insignificant. *W & W Equip. Co. v. Mink*, 568 N.E.2d 564, 574 (Ind. Ct. App. 1991) (citing *Gabhart v. Gabhart*, 370 N.E.2d 345 (1977)).

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<sup>9</sup> A member’s fiduciary duties to other members distinct from the member’s duties to the business entity. This is the familiar *G&N Aircraft* point: the defendant Goldsmith was found not to have breached his fiduciary duty of care to the corporation but was found to have breached his fiduciary duty to Boehm as a fellow shareholder.

<sup>10</sup> A “squeeze-out,” although not a complete “freeze-out,” may form the basis of a claim or counter-claim for breach of fiduciary duty. See, *Supra*, IV(D)(1).

## 5.5 The “Non-Official Capacity” Defense

A person might argue, “even though my actions towards the Corporation for which I am an officer, director, and/or voting shareholder were not open, honest, and/or fair, I cannot be held liable because I was acting in  [fill in the blank]  capacity, NOT in my “official capacity” as an officer, director, or voting shareholder.” Indeed, the Indiana Supreme Court has noted, “Whether . . . duties [are imposed] on majority shareholders in other capacities is an interesting question. However [for purposes of this case] . . . we need not resolve this issue.” *G & N Aircraft, Inc. v. Boehm*, 743 N.E.2d 227, 241 (Ind. 2001). The only hint which the Indiana Supreme Court gave as to which way it might decide this unanswered question of Indiana law was to cite Judge Cardozo’s famous description of the obligation as “not honesty alone, but the punctilio of an honor of the most sensitive.” *Id.*; *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928). “Many forms of conduct permissible in a workaday world for those acting at arm’s length, are forbidden to those bound by fiduciary ties.” *Meinhard*, 164 N.E. at 546.

## 6. Remedies

### 6.2 Monetary Relief

#### 6.2.1 Compensatory Damages

Compensatory (actual) damages are recoverable. *G & N Aircraft, Inc. v. Boehm*, 743 N.E.2d 227, 245 (Ind. 2001).

#### 6.2.2 Punitive Damages

“Punitive damages are recoverable upon clear and convincing evidence that the defendant acted with malice, fraud, gross negligence, or oppression which was not the result of mistake of law or fact, honest error of judgment, overzealousness, mere negligence or other human failing.” *W & W Equipment Co.*, 568 N.E.2d at 577; *Lazarus Department Store v. Sutherlin*, 544 N.E.2d 513, 527 (Ind. Ct. App. 1989).

#### 6.2.3 Disgorgement/“Fee Forfeitures”

Without a requirement for the principal to demonstrate financial loss (see, compensatory damages), disgorgement of ill-gotten gains, including but not limited to “[d]isgorging an agent of all compensation received during a period of employment in which the agent was also breaching a fiduciary duty to the principal,” may be an appropriate equitable remedy. *Wenzel v. Hopper &*

*Gallihier, P.C.*, 830 N.E.2d 996, 1001 (Ind. Ct. App. 2005); *G & N Aircraft, Inc.*, 743 N.E.2d at 244.

\*This equitable remedy likely requires the trial court make a finding that the breach was "willful and deliberate." *Id.* at 1000.

#### 6.2.4 Attorneys' Fees

"A shareholder bringing a successful derivative action can recover attorney's fees from the corporation, but . . . there is no basis for recovery from the defendant. The theory underlying an award of fees in a derivative suit is that the recovery goes to the corporation as a whole, not the individual shareholder. The shareholder who has performed a service for the corporation by bringing the derivative action is entitled to be paid [by the corporation] his fees and expenses incurred in conferring that benefit." *G & N Aircraft, Inc.*, 743 N.E.2d at 245.

Accordingly, because direct actions (including direct actions brought under the *Barth* exception to the derivative action rule) seek individual recovery (as opposed to recovery that goes to the corporation as a whole), attorneys' fees are **generally NOT recoverable for direct actions**. *Id.* (Emphasis added).

When the shareholder proceeds on both direct and derivative claims, any attorneys' fee award attributable to time expended pursuing the direct action should be disallowed. *DRW Builders, Inc. v. Richardson*, 679 N.E.2d 902, 908-9 (Ind. Ct. App. 1997).

### 6.3 Injunctive Relief

"As a general proposition, a trial court 'has full discretion to fashion equitable remedies that are complete and fair to all parties involved.'" *G & N Aircraft, Inc.*, 743 N.E.2d at 243; *Hammes v. Frank*, 579 N.E.2d 1348, 1355 (Ind. Ct. App. 1991); *See also*, Ind. Code § 23-18-4-7 ("A court may enforce an [LLC's] operating agreement by injunction or by granting other relief that the court in its discretion determines to be fair and appropriate in the circumstances."). *See generally, Infra*, Chapter 5: TRO's, preliminary and permanent injunctions.

\*The following list of injunctive relief is meant to be illustrative, not exhaustive.

#### 6.3.1 Dissolution/"Forced Buy-Out"

6.3.1.1 In the context of Close Corporations:

In the context of a close corporation, sometimes “corporate marriage[s] cr[y] out for dissolution by the time [they] reach[] the courts” and “no remedy short of a forced sale [is] appropriate.” *G & N Aircraft, Inc.*, 743 N.E.2d at 243. (Notably, in the context of “a publicly traded corporation, this remedy would not be available [for ‘oppressive conduct’] under Indiana law.”). *Id.*

\*Caution: “This remedy should be exercised only after careful thought.” *Id.* at 244.

#### 6.3.1.2 In the context of LLCs:

Authority for dissolution must be found under either the operating agreement or, alternatively, Indiana’s dissolution statute (Ind. Code § 23-18-9-2), which provides for dissolution “whenever it is not reasonably practicable to carry on the business in conformity with the articles of organization or operating agreement.” *Id.*

#### 6.3.1.3 When determining FMV:

Bear in mind, “[i]f there is a minority discount, there is also a majority premium.” *G & N Aircraft, Inc. v. Boehm*, 743 N.E.2d 227, 244 (Ind. 2001). See also, Murdock, Charles W., *The Evolution of Effective Remedies for Minority Shareholders and its Impact upon Valuation of Minority Shares*, 65 Notre Dame L. Rev. 425, 431 (1990).

Valuation of minority interests must take into account the recent blockbuster case of *Hartman v. BigInch Fabricators & Constr. Holding Co., Inc.*, 161 N.E.3d 1218 (Ind. 2021). The shareholders of a closely held Indiana corporation had an agreement among themselves and the corporation that required the corporation to purchase the shares of any shareholder who was involuntarily terminated as an employee. The agreement provided that the terminated shareholder would be paid the “appraised market value” of the shareholder’s shares determined according to GAAP by an independent appraiser. Did discounts for lack of marketability and lack of control did apply? The Supreme Court held that they did – but only a matter of contract interpretation, not as a statement of common law that would be applicable in any other case except one with identical contract language.

### 6.3.2 Removal (a.k.a., Expulsion)

When an officer, director, or manager breaches his fiduciary duties (and there is some indication said officer, director, or manager is likely to continue to breach his fiduciary duties, causing irreparable harm in the future), most, if not all, jurisdictions grant courts the equitable discretion to “chang[e] his role from one of an active participant in the management of [the company] to the more passive role of an investor in the company.” *Dunbar Group, LLC v. Tignor*, 593 S.E.2d 216, 219 (Va. 2004).

\*Note: Be cognizant that removal will sometimes warrant dissolution.<sup>11</sup>

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<sup>11</sup> Compare, *Tully v. McLean*, 948 N.E.2d 714, 726 (Ill. App. Ct. 1st Dist. 2011) (holding where the faithless fiduciary was judicially removed as a manager-member and where the operating agreement explicitly provided that, in the event of the “removal” of a manager, the company “shall be dissolved,” dissolution was required by the operating agreement, and was not discretionary) with *Dunbar Group, LLC v. Tignor*, 593 S.E.2d 216, 219 (Va. 2004) (holding where the faithless fiduciary was judicially removed as a manager-member but where the operating agreement explicitly provided that termination of a membership would not cause dissolution, dissolution was not warranted by the operating agreement and, therefore, the trial Court erred in ordering dissolution without making the proper findings that dissolution was otherwise warranted by that state’s dissolution statute).

## **Chapter 3: The Uniform Business Organizations Administrative Provisions Act (i.e., the “Business Harmonization Act”)**

### **1. Prior Acts Governing Business Entities (Pre-“Harmonization”)**

Before the passage of the Uniform Business Organizations Administrative Provisions Act (2018) (the “Harmonization Act”), five major business entity statutes authorized and governed Indiana business entities. See Frank Sullivan, Jr., *ARTICLE: BANKING, BUSINESS, AND CONTRACT LAW*, 51 Ind. L. Rev. 945, 946 (2018). The Harmonization Act incorporated, consolidated, and updated these five statutes. *Id.* In 1914, Indiana passed the Uniform Partnership Act (the “UPA”). Ind. Code § 23-4-1-1 (1987). The UPA governed general partnerships, and in 1995, UPA was amended to include governance over Limited Liability Partnerships. Ind. Code § 23-4-1-44 to 52 (1995).

In 1986, Indiana passed the Business Corporation Law (the “BCL”). Ind. Code § 23-1-17 to 54 (1986). The changes made in corporate law by the BCL were an answer to laws that had become “archaic” and “not flexible” to the times. Edwin J. Simcox, *The Indiana Business Corporation Law: Tool For Flexibility, Simplicity and Uniformity*, 20 IND. L. REV. 119, 119 (1987). Additionally, the Harmonization Act also covers Professional Corporations and benefit corporations. Ind. Code § 23-1.3 (2016) & § 23-1.5 (1983).

In 1988, the Indiana Limited Partnership Act (the “ILPA”) authorized and governed limited partnerships. Ind. Code § 23-16 (1988). A few years later, Nonprofit Corporations were authorized and governed by article 17 of title 23 of the Indiana Code. Ind. Code § 23-17 (2011).

Finally, in 1993, Limited Liability Companies were created and governed by the Indiana Business Flexibility Act (the “IBFA”). Ind. Code § 23-18 (2017). In 2016, The IBFA was amended to also include Series LLCs, “a highly-specialized form of business entity.” Sullivan, *supra*, at 947.

### **2. The Uniform Business Organizations Administrative Provisions Act**

#### **2.1 Two Principal Sections - HUB and META<sup>12</sup>**

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<sup>12</sup> Note: Official comments have now been published for HUB and META. They are available on the SOS website: <https://www.in.gov/sos/business/>. Also at that site is a detailed “map” correlating the prior and current sections of the code affected by the Harmonization Act.

The Harmonization Act was adopted by the Legislature as Senate Bill 443 and became Public Law 118-2017 and adopted on January 1, 2018. The Harmonization Act has two principal sections: First, Section 5, nicknamed the "HUB", codified at Ind. Code § 23-0.5; and Second, Section 6 nicknamed "META", codified at Ind. § 23-0.6." Sullivan, *supra*, at 946.

HUB "Includes standard rules for all entity types related to filings, names, registered agents, foreign entities, administrative dissolutions, and various other miscellaneous provisions." Cannon, *supra*. Existing provisions in the above business entity statutes were consolidated into the HUB; what previously took up twenty-eight chapters of Indiana Code now occupies six chapters. *Id.* at 946.

META "Includes new and consolidated provisions addressing mergers, interest exchanges, conversions and domestications as to certain entity types." Cannon, *supra*. The consolidated provisions shrunk ten chapters of Indiana Code into four. Sullivan, *supra*, at 946.

Due to the consolidation of prior business entity statutes, HUB and META refer to all of the entities found in those statutes as a "business entity." A "business entity" is defined as "a business corporation; a nonprofit corporation; a general partnership, including a limited liability partnership; a limited partnership; or a limited liability company." Ind. Code § 23-0.5-1.5-8 (2018).

## **2.2 Procedural Simplification**

One of the Harmonization Act's purposes was to consolidate code provisions found in the business entity statutes discussed above. Sullivan, *supra* at 948-949. However, those statutes were not identical, and some statutes were silent as to matters found in other business entity statutes. Sullivan, *supra*, at 948. This section delves into the procedural consolidation that the Harmonization Act endeavored to enact. This section is not exhaustive but covers the more critical areas of consolidation and simplification of the Harmonization Act: exclusive name reservations, the internal affairs doctrine, what constitutes doing business, registering to do business in Indiana, and terminating foreign registrations.

### **2.2.1 Name Reservation Requirements**

Prior law covered the administrative process of exclusive name reservations under Ind. Code § 23-1-23-2(a), Ind. Code § 23-4-1-45.3(a), and Ind. Code § 23-18-2-9(a). The HUB consolidated these sections into Ind. Code § 23-0.5-3-3(a). The consolidated section governs how to request a name for a business entity. Ind. Code § 23-0.5-3-3(a) (2018). A person can reserve the exclusive right to use



a name by delivering an electronic application to the secretary of state. *Id.* The application must include the person's name and address, and reserved name, excluding words and abbreviations described in Ind. Code § 23-0.5-3-1(c). *Id.* The secretary of state will verify the availability of the name. Ind. Code § 23-0.5-3-1. If the name is available, the secretary of state will reserve the name for the person's exclusive use for renewable one hundred twenty (120) day periods. *Id.*

### 2.2.2 Internal Affairs Doctrine

Corporate law references the internal affairs doctrine, used as a conflict of laws principle which recognizes that only one State should have the authority to regulate a corporation's internal affairs. *Edgar v. Mite Corp.*, 457 U.S. 624, 645 (1982). Indiana had previously codified this doctrine under Ind. Code § 23-1-49-5(c), Ind. Code § 23-4-1-49(c), Ind. Code § 23-16-10(a), Ind. Code § 23-17-26-5(c), and Ind. Code § 23-18-11-1(a). The HUB consolidated these sections into Ind. Code § 23-0.5-5-1(a) (2018). The section states that the law of the jurisdiction of entity formation governs both the internal affairs of the entity and the entity's personal liability for its obligations. Ind. Code § 23-0.5-5-1(a). The jurisdictional portion is a consolidation of the previous statutes; however, it is important to note Ind. Code § 23-0.5-5-1(a) further requires that the internal affairs doctrine control in regard to a business entity's personal liability obligations. *Id.*

### 2.2.3 Doing Business

Most of the prior business entity statutes had a section defining what it meant to be a foreign business entity "doing business" in Indiana. Ind. Code § 23-1-49-1(b); Ind. Code § 23-16-10-2(b); Ind. Code § 23-17-26-1; Ind. Code § 23-18-11-2(b). The HUB consolidated these sections into Ind. Code § 23-0.5-5-5(a). Like the previous code sections, the HUB defined activities that did not constitute "doing business" in Indiana:

- (1) maintaining, defending, mediating, arbitrating, or settling an action or proceeding;
- (2) carrying on any activity concerning its internal affairs, including holding meetings of its interest holders or governing persons;
- (3) maintaining accounts in financial institutions;
- (4) maintaining offices or agencies for the transfer, exchange, and registration of securities of the entity or maintaining trustees or depositories with respect to those securities;
- (5) selling through independent contractors;

- (6) soliciting or obtaining orders by any means if the orders require acceptance outside Indiana before they become contracts;
- (7) making loans or otherwise creating or acquiring indebtedness, mortgages, or security interests in real or personal property;
- (8) securing or collecting debts or enforcing mortgages or security interests in property securing the debts, and holding, protecting, or maintaining property so acquired;
- (9) conducting an isolated transaction completed within thirty (30) days that is not conducted in the course of repeated transactions of a like nature;
- (10) owning, without more, property;
- (11) doing business in interstate commerce; and
- (12) if the entity is a nonprofit corporation, soliciting funds if otherwise authorized by Indiana law. Ind. Code § 23-0.5-5-5(a)(1)-(12) (2018).

#### 2.2.4 Registered Foreign Entity

A foreign business entity must be registered with the secretary of state before it can do business in Indiana. Ind. Code § 23-0.5-5-3 (2018). Previously, Indiana governed this process under Ind. Code § 23-1-49-3(a), Ind. Code § 23-4-1-49(a)(2), Ind. Code § 23-16-10-2(a), Ind. Code § 23-17-26-3(a), and Ind. Code § 23-18-11-4(a). The HUB consolidated these sections into Ind. Code § 23-0.5-5-3. That section states:

To register to do business in Indiana, a foreign entity must deliver a foreign registration statement to the secretary of state for filing. The statement must be signed by the entity and state or be accompanied by:

- (1) the name of the foreign entity and, if the name does not comply with Ind. Code § 23-0.5-3-1, an alternate name adopted under section 6(a) [IC 23-0.5-5-6(a)] of this chapter;
- (2) the type of entity;
- (3) the entity's jurisdiction of formation;
- (4) the date of formation in the jurisdiction described in subdivision (3);
- (5) the street address of the entity's principal office:

- (6) the information required by Ind. Code § 23-0.5-4-3(b);
- (7) if the entity is a nonprofit corporation, whether the corporation has members;
- (8) if the entity is a nonprofit corporation, whether the corporation, if the corporation had been incorporated in Indiana, would be a public benefit, mutual benefit, or religious corporation;
- (9) if the entity is a limited liability company and if the organizational documents of the entity provide for a manager or managers, a statement to that effect; and
- (10) a certificate of existence or similar document authenticated by the secretary of state or other official having custody of business records of the entity in the state or country where the entity was organized. Ind. Code § 23-0.5-5-3(1)-(10) (2018).

### 2.2.5 Termination of Foreign Registration

When a foreign entity is registered to “do business,” the registration may ultimately be terminated as per Ind. Code § 23-0.5-5-11. Previously, Indiana governed termination of a foreign entity registration under Ind. Code § 23-1-51-1 through 3, Ind. Code § 23-17-26-12 through 14, and Ind. Code § 23-18-11-15 through 17. The HUB consolidated these sections into Ind. Code § 23-0.5-5-11. Under this section, the secretary of state may revoke a foreign entity’s registration for one of five reasons. First, the foreign entity is sixty (60) days delinquent on payment of “any fee, tax, interest, or penalty required to be paid to the secretary of state under this article or law of Indiana other than this article.” Ind. Code § 23-0.5-5-11(a)(1) (2018). Second, the foreign entity is sixty (60) days delinquent on filing a biennial report. *Id.* at (a)(2). Third, the foreign entity does not have a registered agent. Ind. Code § 23-0.5-5-11(a)(3) (2018), controlled by requirements of Ind. Code § 23-0.5-4-1. Fourth, the foreign entity does not file a statement of change within thirty (30) days after a change in the entity’s registered agent’s name or address. Ind. Code § 23-0.5-5-11(a)(4) (2018), controlled by requirement in Ind. Code § 23-0.5-4-6. Fifth, the foreign entity dissolved or disappeared in another state. Ind. Code § 23-0.5-5-11(a)(5) (2018), *an authenticated certificate from the secretary of state of the state the entity dissolved or disappeared in is required.* Once the secretary of state decides one of the five above grounds exist, written notice of that determination must be provided to the foreign entity. Ind. Code § 23-0.5-5-11(b) (2018). Two exceptions to notice are when service upon the registered

agent has failed with receipt of the failure, and there is no record of the entity's principal place of business. Ind. Code § 23-0.5-5.11(b)(1-2) (2018). The notice must state the effective date, at least 60 days after the secretary of state delivers the copy of the notice, and the grounds for revocation. Ind. Code § 23-0.5-5.11(c)(1-2) (2018).

The authority of the foreign entity ceases on the effective date of the revocation unless the entity has cured before then. Ind. Code § 23-0.5-5.11(d) (2018).

## **2.3 Substantive change**

While the Harmonization Act is much more of a re-codification project than it is a change in substantive law, the very fact that harmonization of disparate provision is required means that the Harmonization Act's HUB and META articles contains some substantive changes from prior law.. Sullivan, *supra*, at 951. As before, this section is not exhaustive and only includes important changes. The substantive changes in this section are assumed business name exclusivity, biennial reporting, commercial registered agents, interest exchanges, and domestication.

### **2.3.1 Assumed Business Exclusivity**

HUB requires the name under which a domestic filing entity may be formed, the name under which a foreign entity may register to do business in Indiana, or an assumed business name must be distinguishable on the records of the secretary of state from any:

- (1) name of an existing domestic filing entity;
- (2) name of a domestic filing entity that has not been administratively dissolved for more than one hundred twenty (120) days;
- (3) name of a foreign entity registered to do business in this state under Ind. Code § 23-0.5-5;
- (4) name reserved under section 3 of this chapter, Ind. Code § 23-1-23 (before its repeal), Ind. Code § 23-16-2-2 (before its repeal), Ind. Code § 23-17-5 (before its repeal), or Ind. Code § 23-18-2-9 (before its repeal);
- (5) assumed name registered under Ind. Code § 23-15-1-1(e) (before that chapter's repeal); or
- (6) assumed name registered under section 4(e) [Ind. Code § 23-0.5-3-4(e)] of this chapter.

Ind. Code § 23-0.5-3-1(a)(1-6) (2018).

Previous law worked pretty much the same as this new enactment - business entity legal names must be exclusive, that is, distinguishable from each other. *See generally* Ind. Code § 23-1-23-1; Ind. Code § 23-1-49-6; Ind. Code § 23-4-1-45; Ind. Code § 23-16-2-1; Ind. Code § 23-16-10-4; Ind. Code § 23-17-5-1; Ind. Code § 23-17-26-6; Ind. Code § 23-18-2-8; Ind. Code § 23-18-11-7. However, previous law did not handle the exclusivity of assumed business names or a d/b/a. Sullivan, *supra*, at 952. For example, if a person was trying to register the name of "ABC Corp.," the secretary of state would only check to see if "ABC Corp." was an existing domestic or foreign registered corporation. *Id.* The secretary of state would not check if "ABC Corp." was an existing assumed business name. *Id.* The HUB remedied this risk by requiring assumed business name exclusivity. *Id.*

A small area of concern arises under Ind. Code § 23-0.5-3-4(a)-(d) which requires certain business entities to file with a county recorder. Ind. Code § 23-0.5-3-4(a)-(d) (2018). The problem is that HUB does not require the secretary of state to check counties for assumed business names. Sullivan, *supra*, at 952.

Also, the secretary of state may reserve for a requesting business entity the name of a business entity that was administratively dissolved within the past 120 days. Ind. Code § 23-0.5-3-1(a)(2) (2018). The reserved name can only be used as an assumed business name; the requesting business entity must wait until after 120 days has passed to reserve it as its legal name. Smith, *supra*.

### 2.3.2 Biennial Reports

The HUB has made changes to business entity biennial reporting. Previous law mandated that corporations, nonprofit corporations, and limited liability corporations file a report referred to as a biennial report every other year. Ind. Code § 23-1-53-3 (1996); Ind. Code § 23-17-27-8 (2016); Ind. Code § 23-18-12-11 (1997). There was no previous requirement for limited partnerships and limited liability partnerships to file biennial reports. The HUB changed this, and now limited partnerships and limited liability partnerships, domestic or foreign, are required to file a biennial report every other year. Ind. Code § 23-0.5-2-13 (2018).

The report must contain:

- (1) the name of the entity and, if a registered foreign entity, its jurisdiction of formation;
- (2) the information required by Ind. Code § 23-0.5-4-3(b);
- (3) the street address of the entity's principal office;
- (4) for a corporation, the names and business addresses of its directors, secretary, and the highest executive office of the corporation; and
- (5) for a nonprofit corporation, the names and business or resident addresses of its directors, secretary, and highest executive officer. Ind. Code § 23-0.5-2-13(a)(1-5) (2018).

### 2.3.3 Commercial Registered Agents

One way to properly serve a business entity is serving the entity's registered agent. Ind. Code § 23-0.5-1.5-36.

Under HUB, registered agents have been affected in two ways. First, a registered agent that is an entity must be organized under Indiana law or registered to do business in Indiana. *See* Ind. Code § 23-0.5-4-3(a) (2018) (A registered agent must be an individual, a general partnership, a domestic filing entity, or a registered foreign entity.). Second, "Commercial Registered Agents" ("CRA") are recognized. *See* Ind. Code § 23-0.5-1.5-4 (2018) ("Commercial registered agent" means a person listed under Ind. Code § 23-0.5-4-4). A CRA may be any person, organization, or other entity that files a commercial registered agent listing statement with the secretary of state. Ind. Code § 23-0.5-4-4(a) (2018). The statement must state:

- (1) the name of the individual or the name of the entity, type of entity, and jurisdiction of formation of the entity;
- (2) that the person is in the business of serving as a commercial registered agent in this state;
- (3) the address of a place of business of the person in this state to which service of process, notices, and demands being served on or sent to entities represented by the person may be delivered;
- (4) the name of any entity represented or known to be represented by the commercial registered agent; and
- (5) the electronic mail address of the registered agent at which the registered agent will accept electronic

service of process only in the manner prescribed by the Indiana Supreme Court in the Indiana trial rules. Ind. Code § 23-0.5-4-4(a)(1-5) (2018).

The CRAs have access to an online portal where they may make changes to their contact information. Cannon, *supra*. Previously, a registered agent would have to file a change of information statement for each of its clients. Sullivan, *supra* at 954. Now, when a CRA changes its address in the portal, all the CRA's clients will be updated by that change. Sullivan, *supra*, at 954. This change will greatly simplify the process of change of contact information for registered CRAs. *Id.* While registering as CRAs was primarily designed for professional service companies, it offers the same advantages to law firms that serve as registered agents. *Id.*

#### 2.3.4 Interest Exchanges

Interest exchanges apply to the acquisition of all of the ownership interest of one entity by another. Smith, *supra*. Under previous law, only corporations were permitted to transact this way, in what is called a share exchange. Ind. Code § 23-1-40-2 (1986). Under META, for the first-time interest exchanges were permitted as between LLPs, between LPs, and between LLCs. Ind. Code § 23-0.6-3-1 (2018). META also allowed for cross-species interest exchanges between corporations, LLPs, LPs, and LLCs. Sullivan, *supra*, at 955; Ind. Code § 23-0.6-3-1 (2018). A cross-species interest exchange would be one where a corporation acquires an LLC by exchanging corporate shares for all equity interest in the LLC. Sullivan, *supra*, at 955.

#### 2.3.5 Domestication

Domestication is the process where a foreign entity becomes an entity of the same type in a different state if authorized to do so in that state. Ind. Code § 23-0.6-5-1(a) (2018). Prior law only allowed corporations and non-profit corporations to domesticate, whether to Indiana or from Indiana. Ind. Code § 23-1-38.5-4 (2006); § 23-17-31-1 (2014). Under META, all business entities are allowed to domesticate. Ind. Code § 23-0.6-5-1(a) (2018). That means an Indiana LLC can become a foreign LLC in another state if that state's laws allow it, and a foreign LLC can become an Indiana LLC if Indiana's laws allow it.

## 2.4 Final Notes and Nuances

#### 2.4.1 Mergers.

Mergers between business corporations (domestic and foreign) will continue to be governed by the BCL. Ind. Code § 23-0.6-2-1(c) (2018). Also, a merger between domestic or foreign nonprofit corporations will continue to be governed by Article 17. Ind. Code § 23-0.6-2-1(d) (2018). META will govern all cross-species mergers, including cross-species mergers with corporations. Ind. Code § 23-0.6-2-1(a) (2018).

#### 2.4.2 Dissenter's appraisal rights.

Dissenter's appraisal rights are not affected by META. Ind. Code § 23-0.6-1-8 (2018). Any appraisal rights that existed prior to META will be respected as to domestic or foreign entities, in any merger, acquisition, conversion, or domestication. *Id.*; Sullivan, *supra*, at 958.



# Chapter 4: Piercing the Corporate Veil

## Introductory Note to Piercing the Corporate Veil

Frank Sullivan, Jr.

"Piercing the corporate veil" constitutes a common law exception to the general rule that the liability of shareholders for the debts and obligations of a corporation is limited to the amount of their investment.

Limitation on the liability of corporate shareholders was not part of our English common law heritage. Rather, it emerged in this country as a new legal tool to help meet the economic challenges of the day. By 1840, virtually all state legislatures had determined that the "furthering of capital formation could best be accomplished by encouraging shareholders to invest through limiting their liability." Stephen B. Presser, *Thwarting the Killing of the Corporation: Limited Liability, Democracy, and Economics*, 87 Nw.U.L.Rev. 148, 155 (1992). Historically, the imposition of limited liability was perceived as a means of encouraging the small-scale entrepreneur and of keeping entry into business markets competitive and democratic. This rationale gave rise to the fundamental principle of American corporate law that corporate shareholders sustain liability for corporate acts only to the extent of their investment and are not held personally liable for acts attributable to the corporation.

This principle of limited liability of corporate shareholders has been the common law of Indiana at least since 1897. *Gainey v. Gilson*, 149 Ind. 58, 48 N.E. 633 (1897). The Indiana General Assembly codified this principle when it enacted the Indiana Business Corporation Law (BCL) in 1986, providing that "a shareholder of a corporation is not personally liable for the acts or debts of the corporation." Ind. Code § 23-1-26-3(b). At the same time, the legislature also codified the common law exception to this principle by providing that "the shareholder may become personally liable by reason of the shareholder's own acts or conduct."

In *Aronson v. Price*, 644 N.E.2d 864 (Ind. 1994), the Indiana Supreme Court set forth a comprehensive restatement of the general rule of limited liability and the situations in which piercing the corporate veil would be enforced. "While an Indiana court will impose personal liability to protect innocent third parties from fraud or injustice," *Aronson* said, "the burden is on the party seeking to pierce the corporate veil to prove that the corporate form was so ignored, controlled or manipulated that it was merely the instrumentality of another and that the misuse of the corporate form would constitute a fraud or promote injustice."

*Aronson* went on to say that "[i]n deciding whether a plaintiff has met this burden of proof, an Indiana court considers whether the plaintiff has presented evidence showing":

- Undercapitalization;
- Absence of corporate records;
- Fraudulent representation by corporation shareholders or directors;

- Use of the corporation to promote fraud, injustice, or illegal activities;
- Payment by the corporation of individual obligations;
- Commingling of assets and affairs;
- Failure to observe required corporate formalities; or
- Other shareholder acts or conduct ignoring, controlling, or manipulating the corporate form.

In *Aronson*, the plaintiff sought damages from the owner of a corporation which the plaintiff alleged had been negligent in restoring the plaintiff's antique automobile. The Court found that the plaintiff had not met his burden of proving "misuse of the corporate form constituting a fraud or promoting injustice" and held that piercing the corporate veil was therefore unwarranted. An issue in the case that the majority found not dispositive was that the Corporation had been operated under an assumed business name without having made the requisite filing. One justice was of the view that the owner was subject to personal liability as the agent of an undisclosed principal, namely the corporation.

In evaluating a litigant's request that the corporate veil be pierced, Indiana courts apply the mandate of *Aronson*. For example, in *Escobedo v. BHM Health Associates, Inc.*, 818 N.E.2d 930 (Ind. 2004), where employees of a defunct corporation sought to pierce the corporate veil to recover unpaid wages from the corporation's individual shareholders, the Supreme Court held that "promoting substantial justice" was an insufficient basis for piercing the corporate veil. "[T]he evidence [must] meet the two-prong test that the corporate form was so ignored, controlled, or manipulated that it was merely the instrumentality of another and that the misuse of the corporate form would constitute a fraud or promote injustice," the Court wrote. After reviewing the nine factors set forth in *Aronson*, the Court held that the test was not satisfied and refused to pierce the corporate veil.

Another example is *Country Contractors, Inc. v. A Westside Storage of Indianapolis, Inc.*, 4 N.E.3d 677 (Ind. Ct. App. 2014). The plaintiff in this case sued a contractor and its two shareholders for breach of a contract to provide excavation services. The trial court pierced the corporate veil, emphasizing that due to the contractor's bankruptcy, the plaintiff had "no other recourse" except against the shareholders. The Court of Appeals rejected this approach, observing that the "same could be said for any entity that contracts with a company that ends up in bankruptcy." Rather, the Court of Appeals applied the two-part test enunciated in *Aronson*, including a review of the nine factors, and concluded that the trial court clearly erred in piercing the veil and reversed its judgment as to the shareholders.

*Longhi v. Mazzoni*, 914 N.E.2d 834 (Ind. Ct. App. 2009), is an example of a case in which the corporate veil was pierced. The plaintiffs in that case had deposited with a corporation a substantial sum as earnest money for the construction of a new home in a subdivision to be developed by the corporation. When no construction had occurred for two years, the plaintiffs sued the corporation and its owner for a return of their money. The Court of Appeals found the owner of the corporation liable, holding that two of the factors identified in *Aronson* for piercing the corporate veil had been

met: the corporation had been undercapitalized; and the shareholder had used the corporation to promote fraud.

There is substantial additional authority applying *Aronson* to resolve claims seeking to pierce the corporate veil. In *Cnty. Care Centers, Inc. v. Hamilton*, 774 N.E.2d 559 (Ind. Ct. App. 2002), the Court of Appeals quoted a treatise as follows: “[I]t is recognized that the determination of whether there are sufficient grounds for piercing the corporate veil ordinarily should not be disposed of by summary judgment, in view of the complex economic questions often involved, especially if fraud is alleged.” *Id. quoting* 1 William Meade Fletcher, FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 41.95 at 700 (Perm. ed.1999). This is in accord with the following language which appears in many Indiana cases: “[T]here is no one talismanic factor that a court can find to exist which will with impunity justify it in piercing the corporate veil . . . .” This language is most frequently cited to *Stacey-Rand, Inc. v. J.J. Holman, Inc.*, 527 N.E.2d 726 (Ind. Ct. App. 1988)., although it first appeared in *Burger Man, Inc. v. Jordan Paper Products, Inc.*, 352 N.E.2d 821 (1976).

## **Piercing the corporate veil with respect to LLCs**

While the general rule of limited liability and the exception allowing piercing of the corporate veil is well established as to corporations, Indiana law is still evolving with respect to limited liability companies (LLCs). Ind. Code § 23-18-3-3(a) provides:

A member, a manager, an agent, or an employee of a limited liability company is not personally liable for the debts, obligations, or liabilities of the limited liability company, whether arising in contract, tort, or otherwise, or for the acts or omissions of any other member, manager, agent, or employee of the limited liability company.” In the same vein as the BCL, the subsection also provides that “[a] member, a manager, an agent, or an employee of a limited liability company may be personally liable for the person's own acts or omissions.

The Indiana Supreme Court has not yet spoken on the subject. The leading case of the Indiana Court of Appeals is *Troutwine Estates Dev. Co., LLC v. Comsub Design & Eng'g, Inc.*, 854 N.E.2d 890 (Ind. Ct. App. 2006). A real estate development LLC was liable pursuant to the equitable doctrine of unjust enrichment or quantum meruit; the question – one of first impression for Indiana appellate courts – was whether the individual owners of the LLC shared that liability. First, the Court of Appeals cited Ind. Code § 23-18-3-3(a) (set forth above) and concluded that, because of that statute, “individuals associated with a limited liability company are not personally liable merely because of their ownership in the entity, while at the same time, association with a limited liability company does not preclude liability for one's own actions or omissions.”

Next, the court said that “because the [statute] provides protections to limited liability companies like those of corporations, to circumvent those protections we apply an analysis similar to that for determining the personal liability of a corporation's officers.” The court then recited the multi-factor test of *Aronson*, thereby extending the same principle of limited liability and the same exception for piercing the corporate veil to LLCs that apply to corporations.

Troutwine's extension of *Aronson* to LLCs was followed by the Court of Appeals in *Pazmino v. Bose McKinney & Evans, LLP*, 989 N.E.2d 784 (Ind. Ct. App. 2013). And Indiana federal district courts have followed it in a handful of diversity cases:

- *Burget v. R.A.M. Entm't, LLC*, 2015 WL 4490938 (N.D. Ind. July 23, 2015) (Indiana law).
- *Thomas v. Acuity a Mut. Ins. Co.*, 2015 WL 519191 (S.D. Ind. Feb. 9, 2015) (Indiana law).
- *CMG Worldwide, Inc. v. RALS-MM LLC*, 2012 WL 4514142 (S.D. Ind. Sept. 28, 2012) (Indiana law).
- *Lyons v. Durham*, 2012 WL 3915048 (N.D. Ind. Sept. 7, 2012) (Indiana law).
- *MFP Eagle Highlands, LLC v. Am. Health Network of Indiana, LLC*, 2009 WL 77679, at \*9 (S.D. Ind. Jan. 9, 2009) (Indiana law).

## **Enterprise liability (alter ego doctrine)**

*Aronson* specifically concerned piercing the corporate veil in order to hold a shareholder personally liable for a corporate debt. A similar but distinct set of claims seek to hold one corporation liable for another closely related corporation's debt on a theory often referred to as "enterprise liability" or pursuant to the "alter ego doctrine." Note that where corporations are in a parent-subsidary relationship, *Aronson* applies because the parent corporation is the shareholder of the subsidiary corporation. In contrast, enterprise liability imposes liability on a corporation for what might be called a brother or sister corporation's debt. In addition, piercing the corporate veil and enterprise liability claims are sometimes combined in litigation seeking to impose liability upon both a corporation's shareholder and brother-sister corporations.

*Eden United, Inc. v. Short*, 573 N.E.2d 920 (Ind. Ct. App. 1991), is the first Indiana appellate decision to impose liability on an affiliated corporation where "corporations are not operated as separate entities but are manipulated or controlled as one enterprise through their interrelationship to cause illegality, fraud or injustice or to permit one economic entity to escape liability arising out of an operation conducted by one corporation for the benefit of the whole enterprise."

In *Smith v. McLeod Distrib., Inc.*, 744 N.E.2d 459 (Ind. Ct. App. 2000), the Court of Appeals held that two corporations were treated by their owner "as if they were adjunct corporations, or mere alter egos or instrumentalities of each other that shared a common identity" such that one should be held liable for a debt incurred by the other.

In reaching its decision, the Court of Appeals discussed the relationship between piercing and enterprise liability claims. It said that the eight *Aronson* factors are not exclusive when a court is asked to decide whether two or more affiliated corporations should be treated as a single entity. Some of the additional factors to be considered include whether:

- Similar corporate names were used;
- There were common principal corporate officers, directors, and employees;
- The business purposes of the corporations were similar;
- The corporations were located in the same offices and used the same telephone numbers and business cards,

The Court repeated the standard articulated in *Eden United* (quoted above) and went on to say that “[i]ndicia of common ‘identity,’ ‘excessive fragmentation,’ or ‘single business enterprise’ corporations may include, among other factors, the intermingling of business transactions, functions, property, employees, funds, records, and corporate names in dealing with the public.”

Other cases applying or at least discussing enterprise liability and the alter ego doctrine include:

- *Glob. Archery Products, Inc. v. Firgaira*, 2017 WL 1101078 (N.D. Ind. Mar. 22, 2017) (Indiana law).
- *Cont'l Cas. Co. v. Symons*, 817 F.3d 979, 994, 2016 WL 1118566 (7th Cir. 2016) (Indiana law).
- *Reed v. Reid*, 980 N.E.2d 277 (Ind. 2012).
- *Methodist Hosps., Inc. v. Woodrum/Ambulatory Sys. Dev., LLC*, 2010 WL 3326714, at \*5 (N.D. Ind. Aug. 23, 2010) (Indiana law).
- *IGF Ins. Co. v. Cont'l Cas. Co.*, 2009 WL 4016608 (S.D. Ind. Oct. 19, 2009), *aff'd sub nom. Cont'l Cas. Co. v. Symons*, 817 F.3d 979, 2016 WL 1118566 (7th Cir. 2016) (Indiana law).
- *Pitcher v. Royal Flush, Inc.*, No. 48A04–0902–CV–64, 907 N.E.2d 627, 2009 WL 1425193 (Ind. Ct. App. 2009) (unpublished disposition).
- *Schmitt v. Beekay Dev., LLC*, 2008 WL 2691071 (S.D. Ind. July 3, 2008) (Indiana law).
- *Garrido v. Key Bank, N.A.*, No. 49A04–0710–CV–581, 886 N.E.2d 652, 2008 WL 2101879 (Ind. Ct. App. 2008) (unpublished disposition).
- *AGS Capital Corp. v. Prod. Action Int'l, LLC*, 884 N.E.2d 294, 311 (Ind. Ct. App. 2008).
- *Four Seasons Mfg., Inc. v. 1001 Coliseum, LLC*, 870 N.E.2d 494, 505 (Ind. Ct. App. 2007).
- *IGF Ins. Co. v. Cont'l Cas. Co.*, 2007 WL 1068456 (S.D. Ind. Mar. 31, 2007), *aff'd sub nom. Cont'l Cas. Co. v. Symons*, 817 F.3d 979, 2016 WL 1118566 (7th Cir. 2016) (Indiana law).
- *Ayers v. Marathon Ashland Petroleum LLC*, 2007 WL 42975 (S.D. Ind. Jan. 4, 2007) (Indiana law).
- *Lock Realty Corp. IX v. U.S. Health, LP*, 2006 WL 3450597 (N.D. Ind. Nov. 28, 2006), and 2006 WL 2788590 (N.D. Ind. Sept. 25, 2006) (Indiana law).
- *Oliver v. Pinnacle Homes, Inc.*, 769 N.E.2d 1188 (Ind. Ct. App. 2002).
- *Greater Hammond Cmty. Servs., Inc. v. Mutka*, 735 N.E.2d 780 (Ind. 2000).

*Woodruff v. S. Cent. Conference of Seventh Day Adventists*, 2004 WL 612821 (S.D. Ind. Mar. 24, 2004), is an example of a plaintiff invoking the alter ego doctrine in an attempt to acquire personal jurisdiction over a corporation not doing business in Indiana. The court held that the alter ego doctrine was not available to establish personal jurisdiction.

## Partnership by estoppel

A partner in a partnership – unlike a shareholder in a corporation or a member of an LLC – is liable for the debts and obligations of the partnership. Ind. Code § 28-4-1-15(1). As such, an alternative to the theory of piercing the corporate veil for claiming personal liability on the part of a corporate shareholder or LLC member is to demonstrate that the corporation or LLC should be considered a partnership by estoppel which would then subject the shareholder or member to the liability of a partner.

The doctrine of partnership by estoppel was first recognized in Indiana in *Booe v. Caldwell*, 12 Ind. 12, 1859 WL 4838 (1859), and has been codified as Ind. Code § 23-4-1-16. It provides that a person cannot deny the existence of a partnership when that person holds himself out to be in a partnership with another, although no partnership in fact exists, and a third party detrimentally relies on that representation.

In *Reinhart v. Boeck*, 918 N.E.2d 382 (Ind. Ct. App. 2009), an investor in a corporation sought to recover from a promoter for losses incurred in connection with the investment. The promoter defended on the basis that the investor's contract was with the corporation and that corporate shareholders are not personally liable for acts attributable to the corporation. But the evidence showed that the promoter had held himself out to be in a partnership and that the investor had detrimentally relied on that representation. Thus, the Court of Appeals held, a partnership by estoppel existed and the promoter was personally liable for the losses. In imposing liability, the investor having established the elements of a partnership by estoppel was a fully sufficient alternative to meeting the requirements for piercing the corporate veil.

## **De facto corporation and corporation by estoppel**

The *de facto* corporation and corporation by estoppel doctrines allow shareholders of a defective corporation to retain their limited liability when a third party understands its contract to be with the purported corporation. These doctrines have received limited attention in Indiana case law.

In *Sunman-Dearborn Cmty. Sch. Corp. v. Kral-Zepf-Freitag & Associates*, 338 N.E.2d 707 (Ind. Ct. App. 1975) (citing *Jennings v. Dark*, 92 N.E. 778 (Ind. 1910)), the Court of Appeals held that "[d]e facto corporate existence requires (1) a valid law under which the corporation might have been formed, (2) a bona fide attempt to incorporate under that law, and (3) an actual exercise of corporate powers." In *DFS Secured Healthcare Receivables Tr. v. Caregivers Great Lakes, Inc.*, 384 F.3d 338, 2004 WL 2029327 (7th Cir. 2004), the Seventh Circuit held that the test set forth in *Sunman-Dearborn* was not met where the incorporator and sole shareholder signed and filed articles of incorporation, specifying and clearly intending that incorporation be effective at a later date. Because *de facto* status had not been achieved, the shareholder was not shielded from liability for an obligation incurred before the articles became effective.

There is no Indiana case law on "corporations by estoppel." In other jurisdictions, where a defective corporation could not meet the requirements of *de facto* existence, courts nevertheless were willing to shield individuals from liability based on the equities of the case by finding a "corporation by estoppel."

In 1986, the Legislature included the following two sections in Ind. Code § 23-1-21 of the new BCL:

Sec. 3. (a) Unless a delayed effective date is specified, the corporate existence begins when the articles of incorporation are filed. (b) The secretary of state's filing of the articles of incorporation is conclusive proof that the incorporators satisfied all

conditions precedent to incorporation except in a proceeding by the state to cancel or revoke the incorporation or involuntarily dissolve the corporation.

Sec. 4. All persons purporting to act as or on behalf of a corporation, knowing there was no incorporation under this article, are jointly and severally liable for all liabilities created while so acting.

There have been no Indiana decisions interpreting the effect, if any, of these provisions on the common law de facto and estoppel doctrines. *Robertson v. Levy*, 197 A.2d 443 (D.C. 1964), has interpreted these provisions as “eliminat[ing] the concepts of estoppel and de facto corporateness . . . It is immaterial whether the third person believed he was dealing with a corporation or whether he intended to deal with the corporation. The certificate of incorporation provides the cutoff point; before it is issued, the individuals, and not the corporation, are liable.”

## 1. Statement of Rules

Generally speaking, “a shareholder of a corporation is not personally liable for the acts or debts of the corporation . . .” Ind. Code Ann. § 23-1-26-30 (2016). Nor are “corporate officers . . . generally [] personally liable for the contractual obligations of the corporation.”<sup>13</sup> *Winkler v. V.G. Reed & Sons*, 638 N.E.2d 1228, 1231 (Ind. 1994). “These rules are derived from the fact that a corporation is a legal entity separate and distinct from its shareholders and officers.” *Id.* at 1231-32.

“Indiana courts are reluctant to disregard a corporate entity, but will do so to prevent fraud or unfairness to third parties.” *Winkler v. V.G. Reed & Sons*, 638 N.E.2d 1228, 1232 (Ind. 1994); *Gurnik v. Lee*, 587 N.E.2d 706, 710 (Ind. Ct. App. 1992). However, “the burden is on the party seeking to pierce the corporate veil to prove that the corporate form was so ignored, controlled or manipulated that it was merely the instrumentality of another and that the misuse of the corporate form would constitute a fraud or promote injustice.” *Aronson v. Price*, 644 N.E.2d 864, 867 (Ind. 1994); *Winkler*, 638 N.E.2d at 1232. “In deciding whether a plaintiff has met this burden of proof, an Indiana court considers whether the plaintiff has presented evidence showing [the eight *Aronson* factors]:

- undercapitalization;
- absence of corporate records;
- fraudulent representation by corporation shareholders or directors;
- use of the corporation to promote fraud, injustice or illegal activities;
- payment by the corporation of individual obligations;

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<sup>13</sup> Of course, “a corporate officer is personally liable for the torts in which she has participated or which she has authorized or directed.” *Commissioner, Dep’t of Env’tl. Mgmt. v. RLG, Inc.*, 755 N.E.2d 556, 560 (Ind. 2001). Furthermore, a person associated with a corporation may be personally liable under the responsible corporate officer doctrine; the responsible corporate officer doctrine applies to public welfare offenses that impose strict liability by statute, and it is outside the scope of this Treatise. See *Reed v. Reid*, 980 N.E.2d 277, 298 (Ind. 2012).



- commingling of assets and affairs;
- failure to observe required corporate formalities; or
- other shareholder acts or conduct ignoring, controlling, or manipulating the corporate form. *Id.*

“While no one talismanic fact will justify with impunity piercing the corporate veil, a careful review of the entire relationship between various corporate entities, their directors and officers may reveal that such an equitable action is warranted.” *Reed v. Reid*, 980 N.E.2d 277, 301 (Ind. 2012); *Stacey-Rand, Inc. v. J.J. Holman, Inc.*, 527 N.E.2d 726, 728 (Ind. Ct. App. 1988). “The propriety of piercing the corporate veil is highly dependent of the equities of the situation, and the inquiry tends to be highly fact-driven;” therefore, “piercing the corporate veil should only be accomplished on summary judgment in extraordinary circumstances.” *Reed*, 980 N.E.2d at 301.

“Just as equity permits the piercing of a corporate veil to reach the assets of an individual, so too equity permits the piercing of the . . . corporate veil to reach the assets of another closely-related corporation . . .” *Winkler*, 638 N.E.2d at 1234; *Stacey-Rand, Inc.*, 527 N.E.2d at 728. “The corporate alter ego doctrine is a device by which a plaintiff tries to show that two corporations are so closely connected that the plaintiff should be able to sue one for the actions of the other. *Konrad Motor & Welder Serv. v. Magnetech Indus. Servs.*, 973 N.E.2d 1158, 1165 (Ind. Ct. App. 2012). The purpose of the doctrine is to avoid the inequity that results when one corporation uses another corporation as a shield from liability.” *Id.* “Corporate identity may be disregarded under the alter ego doctrine where multiple corporations are operated as a single entity; where they are ‘manipulated or controlled as a single enterprise through their interrelationship to cause illegality, fraud, or injustice or to enable one economic entity to escape liability arising out of an operation conducted by one corporation for the benefit of the whole enterprise.” *Id.*

“The general rule of corporate law, however, is that a corporation will not be held liable for the acts of other corporations, including its subsidiaries. Moreover, distinct corporations, even parent and subsidiary corporations, are presumed separate. To overcome this presumption, a plaintiff must show that one corporation dominated another to the extent that the subordinate was the mere instrumentality of the dominant corporation, that the dominant corporation employed the subordinate to perpetrate a fraud, or that the capital placed in the subordinate was illusory or trifling compared to the business to be done and the risks of loss. The claimant must also demonstrate that the defalcation of the corporations, for example, fraud, was the proximate cause of the injury sustained.” *Greater Hammond Cmty. Servs. v. Mutka*, 735 N.E.2d 780, 784 (Ind. 2000) (internal citations and notations removed); *McQuade v. Draw Tite, Inc.*, 659 N.E.2d 1016, 1020 (Ind. 1995); *Extra Energy Coal Co. v. Diamond Energy and Resources, Inc.*, 467 N.E.2d 439, 441-42 (Ind. Ct. App. 1984).

“In addition, when ‘a plaintiff seeks to pierce the corporate veil in order to hold one corporation liable for another closely related corporation's debt, the eight *Aronson* factors are not exclusive.’ Additional factors to be considered include whether: ‘(1) similar corporate names were used; (2) the corporations shared common principal corporate officers, directors, and employees;



(3) the business purposes of the [organizations] were similar; and (4) the corporations were located in the same offices and used the same telephone numbers and business cards.' Further, a court may disregard the separateness of affiliated corporate entities when they are not operated separately, but rather are managed as 'one enterprise through their interrelationship to cause illegality, fraud, or injustice or to permit one economic entity to escape liability arising out of an operation conducted by one corporation for the benefit of the whole enterprise.' These 'single business enterprise' corporations may be identified by characteristics such as 'the intermingling of business transactions, functions, property, employees, funds, records, and corporate names in dealing with the public.'" *Reed v. Reid*, 980 N.E.2d 277, 301-02 (Ind. 2012); *Oliver v. Pinnacle Homes, Inc.*, 769 N.E.2d 1188, 1192 (Ind. Ct. App. 2002); see also *Eden United, Inc. v. Short*, 573 N.E.2d 920, 933 (Ind. Ct. App. 1991) (identifying additional indicia of "single business enterprise" corporations).

\*"The determination of whether to pierce the corporate veil of a stock corporation or to disregard the protections afforded a limited liability company requires the same analysis." *Troutwine Estates Dev. Co., LLC v. Comsub Design & Eng'g, Inc.*, 854 N.E.2d 890, 899 (Ind. Ct. App. 2006).

\*\*The piercing of the corporate veil, being a matter of equity, is triable by the judge, not a jury. *Stacey-Rand, Inc. v. J.J. Holman, Inc.*, 527 N.E.2d 726, 728 (Ind. Ct. App. 1988). In *Cnty. Care Centers, Inc. v. Hamilton*, 774 N.E.2d 559 (Ind. Ct. App. 2002), the Court of Appeals quoted a treatise as follows: "[I]t is recognized that the determination of whether there are sufficient grounds for piercing the corporate veil ordinarily should not be disposed of by summary judgment, in view of the complex economic questions often involved, especially if fraud is alleged." *Id.* quoting 1 William Meade Fletcher, FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 41.95 at 700 (Perm. ed.1999).

\*\*\*Corporate veil piercing is only a sword to be wielded by plaintiffs, not a shield to be brandished by defendants. *Greater Hammond Cmty. Servs. v. Mutka*, 735 N.E.2d 780, 785 (Ind. 2000).

\*\*\*\* There is some law around the country on "reverse veil piercing" where a creditor of a shareholder seeks to hold a corporation liable for the debts of one of its shareholders. See, e.g., *Phillips v. Englewood Post No. 322 Veterans of Foreign Wars of the United States, Inc.*, 139 P.3d 639 (Colorado 2006). *Mutka* might not preclude a reverse veil piercing claim because it did not involve a creditor of a shareholder seeking to hold a Corporation liable for its shareholder's debts. Rather, one corporation was trying to bring itself under the shield of the Indiana Tort Claims Act by claiming that it was the alter ego of another corporation that enjoyed such protection. On the other hand, the Seventh Circuit has said in *Left Field Media LLC v. City of Chicago, Illinois*, 959 F.3d 839, 841 (7th Cir. 2020) (Illinois law), that "[a] business cannot engage in reverse veil piercing to recover damages for a loss suffered by an investor," citing *In re Deist Forest Products, Inc.*, 850 F.2d 340 (7th Cir. 1988) (Wisconsin law); *Mid-State Fertilizer Co. v. Exchange National Bank*, 877 F.2d 1333 (7th Cir. 1989) (Illinois law).

## 2. Finding the Line – Examples From Case Law

### 2.1 Piercing Inappropriate

*Aronson v. Price*, 644 N.E.2d 864 (Ind. 1994) (failing to notify customer of corporate form is not sufficient to pierce the corporate veil and failing to file an assumed business name, while a breach of corporate formalities, is not by itself sufficient to pierce the corporate veil); *Winkler v. V.G. Reed & Sons*, 638 N.E.2d 1228 (Ind. 1994) (the mere fact of a subsidiary-parent relationship is not by itself sufficient to pierce the corporate veil); *Gurnik v. Lee*, 587 N.E.2d 706 (Ind. Ct. App. 1992) (the mere loaning of funds by a stockholder to a corporation is insufficient to pierce the corporate veil); *Escobedo v. BHM Health Assocs.*, 818 N.E.2d 930 (Ind. 2004) (holding the corporate form was not pierced where, in the midst of liquidation, the shareholders prioritized corporate debt for which they had provided a personal guarantee over other forms of corporate debt); *Country Contrs., Inc. v. A Westside Storage of Indianapolis, Inc.*, 4 N.E.3d 677 (Ind. Ct. App. 2014) (holding piercing improper because: (1) with respect to the undercapitalization factor, undercapitalization does not simply mean that, falling upon rough times, the business ran out of money, but rather capital is to be evaluated at the time of formation, or substantial expansion; and (2) with respect to the disregard of corporate formalities factor, there was no evidence to suggest the act of disregard caused the injustice or inequity or constitutes the fraud); *CBR Event Decorators, Inc. v. Gates*, 962 N.E.2d 1276, 1284 (Ind. Ct. App. 2012) (piercing improper where plaintiff failed to establish a causal connection between misuse of the corporate form and fraud or injustice).

### 2.2 Piercing Appropriate

*Fairfield Dev., Inc. v. Georgetown Woods Senior Apts. L.P.*, 768 N.E.2d 463, 470, 472-73 (Ind. Ct. App. 2002) (piercing veil where the related corporations, and the family that owned them, commingled assets and disregarded corporate formalities); *Clarke Auto Co. v. Fyffe*, 116 N.E.2d 532, 533 (Ind. Ct. App. 1954) (piercing veil regarding a related corporation's sale of stolen goods, because the corporation falsely represented itself as "seller" of the stolen goods to the buyer); *Four Seasons Mfg. v. 1001 Coliseum, LLC*, 870 N.E.2d 494, 505-56 (Ind. Ct. App. 2007) (piercing veil regarding fraudulent asset transfer conducted between two related entities for the purpose of defrauding anticipated creditor); *Longhi v. Mazzoni*, 914 N.E.2d 834, 841, 842-43 (Ind. Ct. App. 2009) (piercing veil where the corporation was undercapitalized and the transaction-in-question was found to be fraudulent); *AGS Capital Corp. v. Prod. Action Int'l, LLC*, 884 N.E.2d 294, 312 (Ind. Ct. App. 2009) (piercing veil where closely-related corporation was used to pose as a potential buyer of competitor for the purpose of procuring a price quote).

### 2.3 Borderline Cases

Most piercing cases fall into the category of, "You know it when you see it." But if you have a "borderline" case, the best, published, borderline case for individual liability is probably *Cnty. Care Ctrs., Inc. v. Hamilton*, 774 N.E.2d 559, 565-70 (Ind. Ct. App. 2002) (ultimately reversing the trial court's grant of summary judgment and remanding, but also providing the trial court detailed guidance on how the eight *Aronson* factors should be evaluated) (emphasis added). The best, published, borderline case for "alter ego" liability of a closely-related corporation or LLC is probably *Smith v. McLeod Distrib., Inc.*, 744 N.E.2d 459 (Ind. Ct. App. 2000); *c.f.*, *Oliver v. Pinnacle Homes, Inc.*, 769 N.E.2d 1188 (Ind. Ct. App. 2002). At the end of the day, because the test is a highly fact-intensive balancing of several factors, there is no discernable bright-line; however, "a trial court's decision to pierce (or not to pierce) the corporate veil will be accorded great deference." *Four Seasons Mfg. v. 1001 Coliseum, LLC*, 870 N.E.2d 494, 504 (Ind. Ct. App. 2007).

# Chapter 5: TROs, Preliminary and Permanent Injunctions

## 1. Temporary Restraining Orders

Ind. Trial Rule 65(B) governs the procedure for the issuance of TROs.

### 1.1 TROs, Generally

TROs are emergency injunctions, designed to preserve the status quo pending a hearing on an application for preliminary injunction. TROs are limited in duration and interlocutory in nature. 42 AM. JUR. 2D *Injunctions* § 8 (2017).

### 1.2 Notice

In general, oral or written notice must be given to the adverse party before a TRO is issued, unless the following two requirements are satisfied:

- it clearly appears from specific facts shown by affidavit or by the verified complaint that immediate and irreparable injury, loss, or damage will result to the applicant before the adverse party can be heard in opposition; and
- the applicant's attorney certifies to the court in writing the efforts, if any, which have been made to give notice and the reasons supporting his claim that notice should not be required. Ind. Trial Rule 65(B)(2).

*Vickery v. Ardagh Glass, Inc.*, 85 N.E.3d 852, 857-58 (Ind. Ct. App. 2017).

Every TRO granted without notice:

- shall be endorsed with the date and hour of issuance;
- shall be filed forthwith in the clerk's office and entered of record;
- shall define the injury and state why it is irreparable and why the order was granted without notice;
- shall expire by its terms within such time after entry, not to exceed ten (10) days. However, an extension may be permitted for good cause shown. Ind. Trial Rule 65(B)(2).

### 1.3 Required Showings

As noted above, the applicant must:

- show she will suffer immediate and irreparable harm if the other party is not enjoined from their actions; and
- certify to the court in writing the efforts, if any, which have been made to give notice and the reasons supporting her claim that notice should not be required. Ind. Trial Rule 65(B).

#### 1.4 **Important Issues for the Court's consideration**

- The immediacy of the harm and whether the circumstance warrants an emergency;
- Why the applicant has not given the opposing party notice; and
- Why the court must rule before the opposing party can be heard.

See T.R. 65(B).

#### 1.5 **Security/Bond**

No TRO shall be issued except upon the posting of a bond or giving of security by the applicant. Ind. Trial Rule 65(C). No such security shall be required of a governmental organization. *Id.*

Amount of security/bond: The court has discretion in terms of what to require for adequate security, but the bond should be sufficient to compensate the adverse party in the event that the TRO has been determined to have been improperly granted. *Howard D. Johnson v. Parkside Development Corp.*, 348 N.E.2d 656, 663 (Ind. Ct. App. 1976). In assessing the amount of the security bond, the trial court may consider the estimated damages offered by the parties and the trial court's own experience and knowledge. *Id.* at 662-63. When an injunction is dissolved and wrongfully entered, the enjoined party is entitled to compensation for the damages he incurred. *Hampton v. Morgan*, 654 N.E.2d 8, 9 (Ind. Ct. App. 1995); *National Sanitary Supply Co. v. Wright*, 644 N.E.2d 903, 905 (Ind. Ct. App. 1994). The damages under Trial Rule 65(C) entitle a person to recover attorney's fees that were incurred defending a wrongful injunction. *Ace Bail Bonds v. Government Payment Service, Inc.*, 892 N.E.2d 702, 707 (Ind. Ct. App. 2008); *Hampton*, 654 N.E.2d at 10; *Wright*, 644 N.E.2d at 905. A party may recover damages, including attorney's fees, even if the trial court erroneously did not require the posting of security. *Wright*, 644 N.E.2d at 905.

#### 1.6 **Form of Order**

As per T.R. 65(D), an order granting a TRO should:

- give the date and time of the granting;
- define the injury, and state why the injury is irreparable;
- explain why the order was granted without notice;
- indicate that the TRO is limited in duration, lasting no longer than ten (10) days. However, upon a showing of good cause, an extension may be permitted. Ind. Trial Rule 65(B).

## 1.7 When Granted

If granted, immediately set a hearing on preliminary injunction at the earliest possible time. If TRO movant declines to proceed with preliminary injunction, then TRO should be dissolved. If adverse party objects to the TRO, the court must provide a hearing on no more than two days' notice.

## 2. Preliminary Injunctions

### 2.1 Authority

Ind. Trial Rule 65(A) governs the procedure for the issuance of preliminary injunctions.

### 2.2 Preliminary Injunctions, Generally

Preliminary injunctions act to prevent irreparable harm (to the moving party) by maintaining the "status quo" during the pendency of an underlying claim. *Crossman Communities, Inc. v. Dean*, 767 N.E.2d 1035, 1042 (Ind. Ct. App. 2002); *Central Indiana Podiatry, P.C. v. Krueger*, 859 N.E.2d 686 (Ind. Ct. App. 2007). In other words, preliminary injunctions function to protect the property and rights of parties from injury until the issues and equities in a case can be determined after a full examination and hearing. *Barlow v. Sipes*, 744 N.E.2d 1, 6, 8 (Ind. Ct. App. 2001). Consequently, preliminary injunctions are prefatory to a hearing on the merits.

- Prohibitory v. Mandatory:

*Prohibitory:* As described above, preliminary injunctions are typically "prohibitory," and act to forbid an action in order to maintain the status quo. *Crossman Communities*, 767 N.E.2d at 1042; *Central Indiana Podiatry, P.C.*, 859 N.E.2d at 686.

*Mandatory*: A mandatory injunction is defined as an injunction that orders an affirmative act or mandates a specified course of conduct. *City of Gary v. Majestic Star Casino, LLC*, 905 N.E.2d 1076, n.6 (Ind. Ct. App. 2009). A mandatory injunction is an extraordinary equitable remedy which should be granted with caution. *Campbell v. Spade*, 617 N.E.2d 580, 583 (Ind. Ct. App. 1993).

## 2.3 Procedure

2.3.1 Consolidation: The court may order the trial of the action on the merits to be advanced and consolidated with the hearing of the application. Ind. Trial Rule 65(A)(2); Indiana Trial Rule 42(A).

\* Judicial Tip: Often preliminary injunctions are the whole case as a practical matter. Other issues may dissipate once the preliminary injunction is ruled upon. Frequently, litigants will want to appeal the preliminary injunction rather than proceed to the final hearing. It is often better practice to hear the preliminary injunction and not intermingle with other issues.

2.3.2 Evidence: Even if consolidation is not ordered, any evidence received upon an application for preliminary injunction which would be admissible upon the trial on the merits, becomes part of the record, and need not be separated at trial. Ind. Trial Rule 65(A)(2).

2.3.3 Urgency of injunction proceedings: Assignment of cases shall not be affected by the fact that a preliminary injunction is sought, but such case shall be assigned promptly and the court regularly assigned to the case shall act upon and hear all matters relating to the preliminary injunction. Ind. Trial Rule 65(A)(3).

The judge shall make himself readily available to consider the preliminary injunction, conduct hearings, fix the manner of giving notice and the time and place for hearings, and shall act and require the parties to act promptly. Ind. Trial Rule 65(A)(3).

\*Judicial Tip: A good rule of thumb is a preliminary injunction hearing ought to be set in approximately two or three weeks if no TRO is sought. If a party seeks a TRO, a hearing should be set approximately seven (7) days from the issuance of the TRO so that the ten (10) days will not have run.

Unless an order is entered within ten (10) days after the hearing upon the granting, modifying, or dissolving of a preliminary injunction, the relief sought shall be subject to the provisions of Ind. Trial Rule 53.1 (“Lazy Judge Motion”).

## 2.4 Notice

Importantly, no preliminary injunction shall be issued without an opportunity for a hearing upon notice to the adverse party. Ind. Trial Rule 65(A)(1). A preliminary injunction “is binding only upon the parties to the action, their officers, agents, servants, employees, and attorneys, and upon those persons in active concert or participation with them who receive *actual notice* of the order by personal service or otherwise.” Ind. Trial Rule 65(D) (emphasis added).

## 2.5 Issuance

The issuance of a preliminary injunction is within the sound discretion of the trial court. *Reilly v. Daly*, 666 N.E.2d 439, 443 (Ind. Ct. App. 1996); *see also Barlow v. Sipes*, 744 N.E.2d 1, 5 (Ind. Ct. App. 2001). However, the power to issue a preliminary injunction should be used sparingly, and such relief should not be granted except in rare circumstances in which the law and facts are clearly within the moving party’s favor. *N. Ind. Pub. Serv. Co. v. Dozier*, 674 N.E.2d 977, 989 (Ind. Ct. App. 1996). When determining whether or not to grant a preliminary injunction, the trial court is required to make special findings of fact and state its conclusion thereon. Ind. Trial Rule 52(A).

## 2.6 Required Showings

The moving party has the burden of showing, by a preponderance of the evidence, that the facts and circumstances entitle him to injunctive relief. *Barlow*, 744 N.E.2d at 5. The trial court’s discretion to grant or deny preliminary injunctive relief is measured by the following four (4) factors:

- whether the plaintiff’s remedies at law are inadequate, thus causing irreparable harm (generally, monetary damages are an adequate legal remedy);
- whether the plaintiff has demonstrated a reasonable likelihood of success at trial by establishing a prima facie case;
- whether the threatened injury to the plaintiff outweighs the threatened harm the grant of the injunction may inflict on the defendant; and



- whether the public interest would be disserved by granting the preliminary injunction.

*Barlow v. Sipes*, 744 N.E.2d 1, 5 (Ind. Ct. App. 2001); *Reilly v. Daly*, 666 N.E.2d 439, 443 (Ind. Ct. App. 1996).

Should the movant fail to prove any of the foregoing requirements, the trial court's grant of an injunction is an abuse of discretion. *In re Reuth Dev. Co.*, 976 N.E.2d 42, 58 (Ind. Ct. App. 2012).

## 2.7 Security/Bond

No preliminary injunction shall be issued except upon the posting of a bond or giving of security by the applicant. Ind. T.R. 65(C). No such security shall be required of a governmental organization. *Id.*

Amount of security/bond: The court has discretion in terms of what to require for adequate security, but the bond should be sufficient to compensate the adverse party in the event that the preliminary injunction has been determined to have been improperly granted. *Howard D. Johnson v. Parkside Development Corp.*, 348 N.E.2d 656, 663 (Ind. Ct. App. 1976). In assessing the amount of the security bond, the trial court may consider the estimated damages offered by the parties and the trial court's own experience and knowledge. *Id.* at 662. When an injunction is dissolved and wrongfully entered, the enjoined party is entitled to compensation for the damages he incurred. *Hampton v. Morgan*, 654 N.E.2d 8, 9 (Ind. Ct. App. 1995); *National Sanity Supply Co. v. Wright*, 644 N.E.2d 903, 905 (Ind. Ct. App. 1994). The damages under Trial Rule 65(C) entitle a person to recover attorney's fees that were incurred defending a wrongful injunction. *Ace Bail Bonds v. Government Payment Service, Inc.*, 892 N.E.2d 702, 707 (Ind. Ct. App. 2008); *Hampton*, 654 N.E.2d at 10; *Wright*, 644 N.E.2d at 905. A party may recover damages, including attorney's fees, even if the trial court erroneously did not require the posting of security. *Wright*, 644 N.E.2d at 905.

## 2.8 Form of Order

Every order granting a preliminary injunction shall include or be accompanied by:

- findings, as required by Ind. Trial Rule 52;
- shall be specific in terms;
- shall describe in reasonable detail, and not by reference to the complaint or other document, the act or acts sought to be restrained; and

- is binding only upon the parties to the action, their officers, agents, servants, employees, and attorneys, and upon those persons in active concert or participation with them who receive actual notice of the order by personal service or otherwise. Ind. Trial Rule 65(D).

### **3. Permanent Injunctions**

#### **3.1 Permanent Injunctions, Generally**

A permanent injunction is issued upon a final determination. *Ferrell v. Dunescape Beach Club Condos. Phase I*, 751 N.E.2d 702, 713 (Ind. Ct. App. 2001). Thus, when the movant seeks a permanent injunction, the second of the four traditionally considered factors is slightly modified, because the issue is not whether the movant has demonstrated a reasonable likelihood of success on the merits, but whether she has, in fact, succeeded on the merits. *Ferrell*, 751 N.E.2d at 712-13; *see also Kosciusko Cty. Cmty. Fair, Inc. v. Clemens*, 143 N.E.3d 310, 314 (Ind. Ct. App. 2020).

#### **3.2 Required Showings**

- whether the plaintiff's remedies at law are inadequate, thus causing irreparable harm (generally, monetary damages are an adequate legal remedy);
- whether the plaintiff has demonstrated her success at trial;
- whether the threatened injury to the plaintiff outweighs the threatened harm the grant of the injunction may inflict on the defendant; and
- whether the public interest would be disserved by granting the preliminary injunction.

*Id.*

# Chapter 6: Receivers and Custodians

## 1. Receiverships

“There are two sources of statutory authority for the appointment of a receiver.” *Dotlich v. Dotlich*, 475 N.E.2d 331, 344 (Ind. App. Ct. 1985), *reh’g denied, trans. denied*. Under Ind. Code § 23-1-47-2(c) of the Indiana Business Corporation Law (“IBCL”), the court may appoint a custodian or receiver *pendente lite* in a judicial proceeding to dissolve a corporation. Ind. Code § 32-30-5-1, on the other hand, governs only receiverships in the causes of action concerning real property.

Courts have occasionally confused the two statutes and appointed a receiver under the wrong provision. See *KeyBank N.A. v. Michael*, 737 N.E.2d 834, 848 (Ind. Ct. App. 2000) (trial court abused its discretion by granting a petition for receivership pursuant to Ind. Code § 23-1-47-1, and by failing to grant the receivership pursuant to [repealed version of Ind. Code § 32-30-5-1]); *Burns-Kish Funeral Homes, Inc. v. Kish Funeral Homes*, 889 N.E.2d 15 (Ind. Ct. App. 2008) (although trial court cited Ind. Code § 32-30-5-1 in its order appointing a receiver, trial court’s conclusion of law made it clear trial court intended to appoint a custodian pursuant to Ind. Code § 23-1-47-2, not a receiver).

### 1.1 Authority

Indiana Code § 32-30-5-1 (2002) grants the court authority to appoint a receiver in certain causes of action concerning real property.

### 1.2 General Considerations

“The appointment of a receiver is an “extraordinary and drastic remedy to be exercised with great caution.” *City of S. Bend v. Century Indem. Co.*, 821 N.E.2d 5, 13 (Ind. App. Ct. 2005); *Crippin Printing Corp. v. Abel*, 441 N.E.2d 1002, 1005 (Ind. Ct. App. 1982), *clarified on reh’g* by 824 N.E.2d 794 (Ind. Ct. App. 2005).

A request for a receiver is not an independent action; it is ancillary to other primary proceedings. *KeyBank*, 737 N.E.2d at 848.

“[T]he standards by which the appointment can be justified are exceptionally stringent based upon the rationale that a court’s power to appoint a receiver is in derogation of the fundamental right of the legal owner of property to possession.” *Crippin*, 441 N.E.2d at 1005.

### 1.3 Grounds for Appointment

A receiver may be appointed by the court in the following cases:

- In an action by a vendor to vacate a fraudulent purchase of property or by a creditor to subject any property or fund to the creditor's claim.
- In actions between partners or persons jointly interested in any property or fund.
- In all actions when it is shown that the property, fund or rent, and profits in controversy are in danger of being lost, removed, or materially injured.
- In actions in which a mortgagee seeks to foreclose a mortgage.
- When a corporation:
  - has been dissolved;
  - is insolvent;
  - is in imminent danger of insolvency; or
  - has forfeited its corporate rights
- To protect or preserve, during the time allowed for redemption, any real estate or interest in real estate sold on execution or order of sale, and to secure rents and profits to the person entitled to the rents and profits.
- In other cases, as may be provided by law or where, in the discretion of the court, it may be necessary to secure ample justice to the parties. Ind. Code § 32-30-5-1 (2002).

## 1.4 **Standard of Review – Abuse of Discretion.**

- 1.4.1 The Indiana Court of Appeals will not reverse an order on a motion to appoint a receiver unless it finds the trial court abused its discretion, which prejudiced the complaining party. *Citizens Fin. Servs. v. Innsbrook Country Club, Inc.*, 833 N.E.2d 1045, 1053 (Ind. Ct. App. 2005).
- 1.4.2 "Trial courts have wide discretionary power to appoint receivers *pendente lite*, but such power should be exercised only when it is clear that no other full and adequate remedy exists whereby justice between the parties may be affected and a wrong prevented." *Ziffrin*, 179 N.E.2d at 279; *Ratcliff v. Ratcliff*, 39 N.E. 2d 435, 438-39 (1942).

## 1.5 **Hearing**

In general, a hearing is required before the appointment of a receiver. 65 AM. JUR. 2D Receivers § 69 *Hearing and determination*.

"A court has authority to order a receivership only after evidence has been presented and findings made showing the necessity of a receivership. However, use of summary proceedings is permitted, especially where no important factual allegations upon are controverted." *Id.*

While much of the Indiana case law on receiverships is fairly dated, the case law supports holding a hearing on a motion to appoint a receiver. *See generally, Maple v. McReynolds*, 196 N.E. 3 (Ind. 1935) (trial court held hearing on motion to appoint a receiver).

## 1.6 Notice

Receivers may not be appointed in any case until the adverse party has appeared or has had reasonable notice of the application for the appointment, except upon sufficient cause shown by affidavit. Ind. Code § 32-30-5-9 (2002).

## 1.7 Sufficiency of Evidence

“In an application for appointment of a receiver, the motion may be supported by affidavits and other written or documentary evidence. The decision will be made based on the moving papers and such answers, affidavits in opposition, or counter-affidavits as may be offered, and also based on the testimony of witnesses in open court if the court deems a hearing advisable. However, a verified petition stating facts based on information and belief is insufficient in order to support the appointment of a receiver.” 65 AM. JUR. 2D Receivers § 68 *Sufficiency*.

## 1.8 Required Showings

Proper statutory grounds for the appointment of a receiver must be sufficiently shown. *Century Indem.*, 821 N.E.2d at 13; *Johnson v. LaPorte Bank & Trust Co.*, 470 N.E.2d 350, 355 (Ind. Ct. App. 1984). Before a receiver may be appointed, the Indiana Supreme Court has found that the party requesting a receiver has the burden of showing by clear and convincing evidence:

- An emergency exists such that the management and operation of a corporation must be taken over at once from those in control.
- Irreparable damage and injury must result unless a receiver is appointed, and
- No adequate remedy is otherwise available. *Lafayette Realty Corp. v. Moller*, 215 N.E.2d 859, 862 (Ind. 1966).

## 1.9 Form of Order

After an evidentiary hearing on a party’s motion to appoint a receiver, the court should enter findings of fact, conclusions of law, and an order appointing or denying the appointment of a receiver.

Specifically, the order may include, but is not limited to:

- Reasons for the emergency and necessity of a receiver;
- Why other remedies are inadequate;
- The irreparable damage and injury that would occur if a receiver is not appointed; and
- A description of the powers and duties of the receiver.
- A fixed time within which the person or members, owners, agents or officers of the business or assets to be placed with the receiver shall file with the clerk of the court a full, complete, itemized affidavit, setting forth in detail all assets and liabilities of the organization, including a list of names and addresses of all known creditors. Ind. Trial Rule 66(B).

### 1.10 **Oath, Written Undertaking, and Surety**

Before beginning duties as a receiver, a receiver must:

- Swear to perform the duties of a receiver faithfully; and
- With one or more sureties approved by the court or judge, execute a written undertaking, payable to such person as the court or the judge directs, to the effect that the receiver will:
  - Faithfully discharge the duties of receiver in the action; and
  - Obey the orders of the court or judge. Ind. Code § 32-30-5-3 (2002).

### 1.11 **Who May Be Appointed as Receiver**

The court may not appoint a party, an attorney representing a party, or another person interested in an action, as the receiver in that action. Ind. Code § 32-30-5-2 (2002).

### 1.12 **Powers and Duties of a Receiver**

The receiver may, under control of the court or judge:

- bring and defend actions;
- take and keep possession of the property;
- receive rents;
- collect debts; and
- sell property

in the receiver's own name, and generally do other acts respecting the property as the court or judge may authorize. Ind. Code § 32-30-5-7 (2003).

## 2. Custodians and Receivers Pendente Lite

### 2.1 Authority

Ind. Code § 23-1-47-2(c) of the Indiana Business Corporation Law ("IBCL"):

A court in a proceeding brought to dissolve a corporation may issue injunctions, appoint a receiver or custodian *pendente lite* with all powers and duties the court directs, take other action required to preserve the corporate assets wherever located, and carry on the business of the corporation until a full hearing can be held. Ind. Code § 23-1-47-2(c) (1986).

*Note:* There is currently no corresponding provision under the Indiana Business Flexibility Act ("IBFA"), Ind. Code § 23-18-1-1 *et seq.*, providing for the appointment of a custodian or receiver when a party brings an action for judicial dissolution of an LLC under Ind. Code § 23-18-9-2.

### 2.2 General Considerations

The purpose of appointing a custodian or receiver *pendente lite* is to preserve the corporate assets and carry on the business of the corporation until a full hearing can be held. Ind. Code § 23-1-47-2 (1986). The court may appoint:

- one (1) or more receivers to wind up and liquidate, or
- one (1) or more custodians to manage.

the business and affairs of the corporation while the litigation is pending. Ind. Code § 23-1-47-3(a) (1986).

### 2.3 Grounds for Appointment

The court may appoint a receiver in a dissolution proceeding brought by a shareholder where:

- 2.3.1 The directors are deadlocked in the management of the corporate affairs, the shareholders are unable to break the deadlock, and irreparable injury to the corporation is threatened or being suffered, or the business and affairs of the corporation can no longer be conducted to the advantage of the shareholders generally, because of the deadlock, or

2.3.2 The shareholders are deadlocked in voting power and have failed, for a period that includes at least two consecutive annual meeting dates, to elect successors to directors whose terms have expired.<sup>14</sup>

"[T]he appointment of a receiver is appropriate only where there is dissention between sets of stockholders owning equal amounts of stock such that there is a present danger to the investors consisting of a serious suspension of or interference with the conduct of the business resulting in an imminent danger of dissipation of the corporate assets." *Crippin*, 441 N.E.2d at 1007.

"[A]s a matter of law, a potential or even probable shareholder deadlock is of itself an insufficient basis for the appointment of a receiver *pendente lite*." *Id.*

In other jurisdictions, in contrast to the foregoing principles of Indiana dissolution law, minority shareholders may petition for dissolution on grounds of either mistreatment of complaining shareholders or misappropriation of corporate assets by controlling shareholders, directors, or officers. See, e.g., *Matter of Kemp & Beatley, Inc.*, 473 N.E.2d 1173, 1180 (N.Y. 1984). The Official Comment to Ind. Code § 23-1-47-1 explains how and why Indiana law differs:

[Prior law] authorize[d] a court to dissolve a corporation if the shareholder establishe[d] that: [(1)] the directors or those in control of the corporation have acted, are acting, or will act in a manner that is illegal, oppressive, or fraudulent; [or].[(2)]. the corporate assets are being misapplied or wasted[.]

The[se] . . . provisions [have been deleted] to protect corporations against "strike suits"--including those that might be filed during a hostile takeover battle--seeking dissolution on the grounds of alleged illegality, oppressiveness, fraud or waste of corporate assets.... [D]erivative proceedings under IC 23-1-32 provide sufficient remedies for such conduct (if proven) and that authorizing the drastic step of judicial dissolution as an additional permitted remedy was inappropriate.

## 2.4 Standard of Review

An appellate court reviews a trial court's order appointing a receiver for an abuse of discretion. *Key Bank*, 737 N.E.2d at 848.

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<sup>14</sup> This rule is synthesized from Ind. Code § 23-1-47-1(2) (stating grounds for judicial dissolution when a shareholder brings an action to dissolve the corporation) and case law. See *Burns-Kish*, 889 N.E.2d at 27 (trial court properly appointed custodian in judicial dissolution proceeding where shareholders were deadlocked in voting power, had failed for at least two consecutive annual meetings to elect successors to directors, and had no shareholder meetings since 1978).



## 2.5 **Hearing and Notice**

The court shall hold a hearing, after notifying all parties to the proceeding and any interested persons designated by the court, before appointing a receiver or custodian. Ind. Code § 23-17-24-3.

## 2.6 **Form of Order**

There is no case law delineating the “required showings” necessary for appointment of a custodian, as there is for the appointment of a receiver. *See supra, Lafayette Realty Corp.*, 215 N.E.2d at 862 (setting out three specific circumstances that must be shown by clear and convincing evidence before the court may appoint a receiver). However, the court may find it helpful to consider the Lafayette factors as guidance for whether to appoint a custodian.

After an evidentiary hearing on a party’s petition to appoint a receiver or custodian, the court should enter Findings of Fact, Conclusions of Law, and an Order appointing or denying the appointment of a receiver or custodian. *See Burns-Kish*, 889 N.E.2d at 20 (trial court entered Findings of Fact, Conclusions of Law, and Order denying request for preliminary injunction and appointing a custodian over corporation).

The court shall describe the powers and duties of the receiver in its appointing order, which may be amended from time to time. Ind. Code § 23-1-47-3(c) (1986).

## 2.7 **Who May Be Appointed as Receiver or Custodian**

The court may appoint an individual or a domestic or foreign corporation (authorized to transact business in Indiana) as a receiver or custodian. Ind. Code § 23-1-47-3(b).

The court during a receivership may re-designate the receiver a custodian, and during a custodianship may re-designate the custodian a receiver, if doing so is in the best interests of the corporation, its shareholders, and creditors. Ind. Code § 23-1-47-3(d).

## 2.8 **Surety/Bond**

The court may require the receiver or custodian to post bond, with or without sureties, in an amount the court directs. Ind. Code § 23-1-47-3(b).

## 2.9 **Powers and Duties of Receivers and Custodians**

### 2.9.1 Receiver

Powers of a receiver appointed under the IBCL to wind up and liquidate the assets of a corporation include but are not limited to:

- disposing of all or any part of the assets of the corporation wherever located, at a public or private sale, if authorized by the court; and
- suing and defending in the receiver's own name as receiver of the corporation in all courts of this state. Ind. Code § 23-1-47-3(c)(1).

### 2.9.2 Custodian

The powers of a custodian are more broad than the powers of a receiver. See *KeyBank*, 737 N.E.2d at 848 n.7 (Ind. Ct. App. 2000) ("trial court explicitly chose to appoint the receiver pursuant to Ind. Code § 23-1-47-1 in order to give the receiver broader powers, e.g., acting as a custodian to resume operation of the business.").

A custodian may exercise all of the powers of the corporation, through or in place of its board of directors or officers, to the extent necessary to manage the affairs of the corporation in the best interests of its shareholders and creditors. Ind. Code § 23-1-47-3(c)(2).

The court from time to time during the receivership or custodianship may order compensation paid and expense disbursements or reimbursements made to the receiver or custodian and the receiver's or custodian's counsel from the assets of the corporation or proceeds from the sale of the assets. Ind. Code § 23-1-47-3(e).

# Chapter 7: Managing Class Actions

## 1. Precertification Case Management

Because the stakes and scope of class action litigation can be immense, class actions require closer judicial oversight and more active judicial management than other types of litigation. These actions present many of the same problems and issues inherent in other types of complex litigation; however, the aggregation of a large number of claims, and the ability to bind individuals who are not named parties, tend to magnify those problems and issues; increase the stakes for the named parties; and create potential risks of prejudice or unfairness for absent class members.

These issues impose special responsibilities on the court and counsel and make case management particularly important. If the action proceeds as a class action, the court will be responsible for reviewing any proposed settlement of the action to determine whether it is fair, reasonable, and adequate – even when the settlement is unopposed. *See, infra*, Section IV.

Before ruling on class certification, the court should address the following matters at an early stage in the case, typically at the initial case management conference.

### 1.1 Jurisdiction

The court should make sure the Commercial Court has jurisdiction over the subject matter and the parties.

### 1.2 Motions

The court should decide whether to hear and determine threshold dispositive motions – particularly motions that do not require extensive discovery – before hearing and determining a class certification motion. These matters can be addressed as part Initial Case Management Conference with the parties.

The court may decide motions such as challenges to jurisdiction and venue; motions to dismiss for failure to state a claim; and motions for summary judgment before a motion to certify the class, although any precertification rulings will only bind the named parties.

*\*Note:* Early resolution of these motions may avoid expense for the parties and burdens for the court and may minimize use of the class action procedure for cases that are not meritorious. If the court decides to hear any threshold motions, the court should set a timetable for their submission.

### 1.3 **Related Cases**

The court should determine whether there are related cases pending in any other court. If there are such cases pending, the judge should note the status of these cases, including pretrial preparation, schedules, and orders.

### 1.4 **Discovery**

The court should ascertain whether any discovery is necessary prior to making a determination on the issue of class certification.

The court should confer with counsel to determine the type and scope of discovery necessary to decide any certification issues, which may or may not overlap with discovery related to the merits of the litigation.

*\*Note:* Discovery that is only relevant to the merits delays the certification decision and may be unnecessary. Courts are generally liberal in allowing discovery that pertains to both the question of certification and the merits. When facts relevant to any of the certification requirements (*see infra*, Section II) are disputed, or when the opposing party contends that proof of the claims or defenses unavoidably raises individual issues, some discovery may be necessary.

*\*\*Note:* Although the court should not decide or even attempt to predict the weight or outcome of the claims and defenses at this early stage, a strong understanding of the parties' positions and nature of the proof is necessary to decide whether the claims and defenses can be presented and resolved on a class-wide basis.

The court should encourage counsel to confer and stipulate as to relevant facts that are not genuinely disputed; to reduce the extent of precertification discovery; and to refine the pertinent issues for deciding class certification.

The court may require the parties to submit a specific and detailed precertification discovery plan which identifies the depositions and other discovery contemplated from other parties, as well as the subject matter to be covered and the reason it is material to determining class certification.

With regard to discovery involving trade secret or potentially sensitive information, the court should also establish the timetable for any motion to seal hearings in compliance with the Rules on Access to Court Records, in particular rules 5 and 6.

## 1.5 Precertification Communications with Proposed Class Members

The court should determine whether there is a need to regulate communications with potential class members before certification.

Some courts have held that, absent specific evidence of abuse, requiring the parties to obtain a court's prior approval of precertification communications is an impermissible prior restraint on protected speech.

Judicial intervention is generally justified only on a clear record and with specific findings which reflect that the court has weighed the need for a limitation against the potential interference with the parties' rights.

Actions the court might take to prevent abuse include:

- requiring the parties to communicate with potential class members only in writing;
- requiring the parties to file with the court copies of all non-privileged communications with class members;
- correcting any inaccurate prior communications;
- reminding plaintiff's counsel that even before certification or a formal attorney-client relationship, class counsel must act in the best interests of the class as a whole; and
- reminding defendant's counsel that while the defendant may communicate with potential class members in the ordinary course of business, the defendant may not give false, misleading, or intimidating information; conceal material information; or attempt to influence the decision about whether to request exclusion from the class.

These matters can be addressed as part of the Initial Case Management Conference.

For further discussion, see *Manual for Complex Litigation, Fourth*, §§ 21.11 (Initial Case-Management Orders), 21.12 (Precertification Communications with the Proposed Class), 21.14 (Precertification Discovery), 21.15 (Relationship with Other Cases Pending During the Precertification Period), and 21.25 (Multiple Cases and Classes: The Effect on Certification).

## 2. Determining Motion for Certification of Action as Class Action

The court should determine whether an action should be certified as a class action at the earliest practicable time, i.e., when the court has sufficient information to decide whether the case meets the criteria for being certified as a class action. At the initial case management conference, the court and counsel should address all issues bearing on certification and establish a schedule for the work necessary to permit an informed ruling on any class certification motion.

Class actions in Indiana are governed by Rule 23 of the Indiana Rules of Trial Procedure. To certify a class, proponents must first satisfy the requirements of Rule 23(a).

### **3. Determining Notice to Be Given to Class Members**

#### **3.1 Certification Notice**

Notice to class members that the action has been certified as a class action (*see supra*, Section II) may be required.

The notice should specify the nature of the action; the definition of the class and any subclasses; and the claims, issues, and defenses for which the class has been certified.

*\*Note:* On its website, the Federal Judicial Center has numerous illustrative forms of class action notices that counsel (and the court) may refer to in drafting a sufficient notice. *See* <https://www.fjc.gov/content/notes-use-attorneys-and-judges>).

- The notice should be stated concisely and clearly, in plain, easily understandable language. The court should review the proposed notice to ascertain that it complies with this element.
- Counsel for the class and the defendants should confer as early as possible to determine potential language of a notice should the case be certified and present to the court an agreed upon notice, if possible. If no agreement on the form of a notice can be reached, each party should be ready to present alternative forms for the court's consideration.
- The court should discuss with counsel whether class members are likely to require notice in a language other than English or in any other accessible form (e.g., in Braille or large print for the visually impaired).

The certification notice should convey the information absent class members need to decide whether to be excluded from or opt out of the class and the opportunity to do so.

- To enable absent class members to make an informed decision, the notice should describe succinctly the positions of the parties; identify the opposing

parties and their counsel; describe the relief sought; and explain the risks and benefits of retaining class membership and opting out, while emphasizing that the court has not ruled on the merits of any claims or defenses. They should be advised that they can object and still participate in the class action if their objection is denied.

- Opt out procedures should be simple and clearly described in the notice.

Notice is generally given in the name of the court, although one of the parties typically prepares and distributes it.

- The plaintiff ordinarily has the responsibility of providing notice and, in most cases, must bear the cost of doing so when certification is granted.
- The court may, however, require the defendant to bear or share the cost of providing notice in certain circumstances, including when the defendant has the ability to provide notice easily and at relatively little cost, or when the defendant's conduct has unnecessarily complicated the problems of identifying and notifying class members.

The certification notice should generally be given by mail when the names and addresses of most class members are known although notice by email is widely accepted.

- Posting notice on Internet sites likely to be visited by class members (including the defendant's web site) and linked to more detailed certification information may be a useful, cost-effective supplement to individual notice.
- Publication of the notice in magazines, newspapers, or trade journals may be necessary when individual class members are not identifiable after reasonable effort or at reasonable cost, or as a supplement to other notice efforts. The court may ask counsel why they have chosen a particular publication in which to give notice.
- Posting notice in public places likely to be frequented by class members may also be an appropriate alternative.

## 3.2 Settlement Notice

Notice of any proposed settlement of the class action (*see infra*, Section IV) must be given to all class members who will be bound by the settlement.

- Settlement notice should define the class and any subclasses, clearly describe the options open to the class members and the deadlines for taking action; describe the essential terms of the proposed settlement; disclose any special benefits provided to the class representatives; provide information regarding any claim for attorney's fees (*see infra*, Section V); indicate the time and place of the hearing to consider approval of the settlement; describe the method for objecting to or opting out of the settlement; explain the procedures for allocating and distributing settlement funds; explain how nonmonetary benefits were valued if the settlement includes them; provide information that will enable class members to calculate or at least estimate their individual recoveries; and give the address and phone number of class counsel and describe how to make inquiries.
- The settlement notice should be delivered or communicated to class members in the same manner as the certification notice.
- The defendant generally pays for the cost of giving notice of the settlement, although the parties may decide or the court may order otherwise.

*Note:* The parties generally use the settlement agreement to allocate the costs of the settlement notice. These costs are often assessed against a fund created by the defendants or to the defendant, in addition to any funds paid to the class.

### 3.3 Other Notices

The court may require other notices for the protection of class members. For further discussion, *see Manual for Complex Litigation, Fourth*, §§ 21.31 (Notices from the Court to the Class), 21.311 (Certification Notice), 21.312 (Settlement Notice), and 21.313 (Other Court Notices).

## 4. Reviewing Proposed Settlement

### 4.1 Court's Role in General

The court must review any proposed settlement of a class action to determine whether it is fair, reasonable, and adequate. In general, the court must examine whether the interests of the class are better served by settlement than by further litigation.

The court's role in reviewing a proposed settlement is critical, but is limited to approving the settlement, disapproving it, or imposing conditions on it. The court cannot rewrite the settlement agreement, although the court's statement of conditions for approval, reasons for disapproval, or discussion of reservations about proposed settlement terms may lead the parties to revise the agreement.



The court must be aware, in the context of settlement, that both sides have a common interest in obtaining the court's approval. Thus, there will not be the ordinary adversarial presentation, and the court must make at least a rough assessment of the merits of the plaintiffs' case in order to assess the fairness of the settlement.

In general, fairness calls for a comparative analysis of the treatment of class members with respect to each other and with respect to similar individuals with similar claims who are not in the class. Reasonableness depends on an analysis of the class allegations and claims, and the responsiveness of the settlement to those claims. Adequacy of the settlement involves a comparison of the relief granted relative to what class members might have obtained through continued class action litigation.

## 4.2 **Factors**

**Many factors may be considered in determining, fairness, reasonableness, and adequacy, including the following:**

4.2.1 The advantages of the proposed settlement versus the probable outcome of a trial on the merits. The court may consider:

- The strength of the plaintiffs' case;
- The probable time, duration, and cost of a trial; and
- The probability that the class claims, issues, or defenses could be maintained through trial on a class basis.

4.2.2 The extent of participation in the settlement negotiations by class members or class representatives, and by a court or a Commercial Court Master.

4.2.3 The number and force of objections by class members.

4.2.3.1 The court should consider the number of objections in light of the individual monetary stakes involved in the litigation.

*Note:* When each class member's recovery is small, a minimal number of objections may reflect apathy rather than satisfaction. When each class member's recovery is high enough to support individual litigation, the percentage of class members who object may be an accurate measure of the class's sentiments toward the settlement.

- The court should distinguish between meritorious objections and those advanced for improper purposes.

- Individual terms more favorable than those applicable to other class members should be approved only on a showing of a reasonable relationship to facts or law that distinguish the objector's position from other class members.

4.2.4 The fairness and reasonableness of the procedure for processing individual claims under the settlement.

4.2.4.1 The court should determine whether the persons chosen to administer the claims procedure are disinterested and free from conflicts arising from representing individual claimants.

4.2.4.2 The court should confirm that the eligibility conditions are not so strict and the claims procedures so cumbersome that class members will be unlikely to claim benefits, particularly if the settlement provides that the unclaimed portions of the fund will revert to the defendant.

4.2.4.3 Completion and documentation of the claims forms should be no more burdensome than necessary.

4.2.4.4 Any release of liability should be narrowly tailored.

4.2.5 The provision for disposition of undistributed or unclaimed funds under Rule 23(F).

4.2.5.1 Judicial approval is required for this disposition.

4.2.5.2 The funds may be returned to the settling defendant, paid to other class members, or distributed to a charitable or nonprofit institution, or to a government agency. To avoid any appearance of impropriety, the court should not suggest the charitable recipient.

4.2.5.3 The court should allow adequate time for late claims before any refund or other disposition of settlement funds occurs and might consider ordering a reserve for late claims.

4.2.5.4 Indiana Trial Rule 23 (F) requires that 25% of the residual funds shall be disbursed to the Indiana Bar Foundation to support pro bono work.

4.2.6 The reasonableness of any provisions for attorney's fees. The court may consider:

- 4.2.6.1 The terms of any agreements affecting the fees to be charged for representing individual claimants or objectors;
  - 4.2.6.2 Whether attorney's fees are based on a very high value ascribed to nonmonetary relief awarded to the class, such as coupons;
  - 4.2.6.3 Whether attorney's fees are based on the allocated settlement funds rather than the funds actually claimed by and distributed to class members;
  - 4.2.6.4 Whether attorney's fees are so high in relation to the actual or probable class recovery that they suggest a strong possibility of collusion; and
  - 4.2.6.5 Whether a portion of the fee award should be withheld until all distributions to class members have been made.
- 4.2.7 The apparent intrinsic fairness (or unfairness) of the settlement terms. For example, the court may consider:
- 4.2.7.1 Whether the named plaintiffs are the only class members to receive monetary relief or are to receive relief that is disproportionately large.  
  
*Note:* Such differences are not necessarily improper, but call for judicial scrutiny. Compensation for class representatives may sometimes be merited based on a factual showing of the time spent meeting with class members or responding to discovery and of the risks assumed. For example, in an employment discrimination case, a named plaintiff may deserve extra compensation because by serving as a named plaintiff, this individual may have made himself or herself less attractive to prospective employers.
  - 4.2.7.2 Whether objectors receive better settlements than other class members.
  - 4.2.7.3 Whether an agreement that grants class members nonmonetary benefits, such as discount coupons for more of the defendant's product, while granting a substantial monetary attorney's fee award, is inherently unfair.

- 4.2.7.4 Whether nonmonetary relief, such as coupons or discounts, is likely to have much, if any, market or other value to the class, and the likelihood that they will be used.
- 4.2.7.5 Whether the settlement amount is much less than the estimated damages incurred by class members as indicated by preliminary discovery or other objective measures.
- 4.2.7.6 Whether the settlement was reached at an early stage of the litigation without substantial discovery and with significant uncertainties remaining.
- 4.2.8 Whether another court has accepted or rejected a substantially similar settlement for a similar class.

For further discussion, see *Hefty v. All Other Members of the Certified Settlement Class*, 680 N.E.2d 843 (Ind. 1997) (setting forth the principles to be used by Indiana trial courts in evaluating proposed settlements in class actions); and see *Manual for Complex Litigation, Fourth*, §§ 21.61 (Judicial Role in Reviewing a Proposed Class Action Settlement), 21.62 (Criteria for Evaluating a Proposed Settlement), 21.63 (Procedures for Reviewing a Proposed Settlement), 21.643 (Role of Objectors in Settlement), 21.66 (Settlement Administration), and 22.92 (Review of Settlement in Mass Tort Class Actions).

## **5. Awarding Attorneys' Fees**

In class actions involving a monetary recovery, the court must determine and/or approve any attorneys' fees. The court has considerable discretion to regulate an attorney's fee award in a class action, whether as part of the settlement of the action or after trial. Calibrating the amount of attorney's fees to a reasonable share of the benefits of a class settlement or award is an appropriate and effective means of managing class action litigation and preventing abuses of the class action procedure.

### **5.1 Non-exclusive examples of what the court can do**

- 5.1.1 When fees are based on a percentage of the recovery, decrease this percentage as the amount of the recovery increases on the theory that a mega fund recovery is generally due merely to the size of the class and may have no relationship to the attorney's efforts.
- 5.1.2 Refuse to allow fees based on an inflated or arbitrary evaluation of the benefits to be delivered to class members.

*Note:* It might be appropriate to require the attorneys to share in the risk of fluctuations in the value of an in-kind settlement, either by taking all or part of their fees in in-kind benefits or by deferring the collection of fees and making them contingent on the value of in-kind benefits that are actually delivered to the class members.

- 5.1.3 Use the lodestar - multiplier method (hours x hourly rate x risk factor at the time of taking the engagement) rather than the percentage-of-recovery method to determine the amount of fees to which the attorneys are entitled when the benefit to the class is speculative.

*Note:* Using the lodestar method may also be appropriate when the primary relief obtained is injunctive or declaratory relief and the value of this relief cannot be reliably determined or estimated.)

- 5.1.4 Reduce the parties' estimates of the dollar value of the benefits delivered to the class members and base the fee award on the reduced amount.
- 5.1.5 Withhold a portion of the fee until a distribution is complete.
- 5.1.6 Any other action that the court determines is just and reasonable under the circumstances.

- 5.2 The party seeking fees has the burden of submitting sufficient information to justify the requested fees. Even in common fund cases, courts may require an estimate of the number of hours spent on the litigation and a statement of the hourly rates for all attorneys and paralegals who worked on the case. This information can serve as a "cross-check" on the determination of the percentage of the common fund that should be awarded as fees. In lodestar or statutory fee award cases, applicants must provide full documentation of hours and rates. However, the Seventh Circuit no longer supports this approach. *See, e.g., "The use of a lodestar cross-check is no longer recommended in the Seventh Circuit." Abbott v. Lockheed Martin Corp.*, No. 06-CV-701-MJR-DGW, 2015 WL 4398475, at \*3 (S.D. Ill. July 17, 2015).

For general factors to consider in awarding attorney's fees in complex cases, *see* § 5.6, *supra*.

For further discussion, *see Manual for Complex Litigation, Fourth*, Chapter 14, Attorney Fees, and §§ 21.7 (Attorney Fee Awards) and 22.927 (Awarding and Allocating Attorney Fees).