NEW MEXICO LAW REVIEW

Volume 17
Issue 2 *Summer 1987*

Summer 1987

Corporate Law

Alfred D. Mathewson

CORPORATE LAW

ALFRED D. MATHEWSON*

INTRODUCTION

This Article reviews certain changes in several areas of New Mexico corporate law under the 1983 Amendments[1] (the "New Mexico Amendments") to the New Mexico Business Corporation Act[2] (the "Act") and those New Mexico decisions between 1982 and 1986 that have contributed to the development of New Mexico corporate law. While the New Mexico Amendments were covered in some depth in Perelson & Compton, *1983 Amendments to the New Mexico Business Corporation Act and Related Statutes*,[3] at least three areas deserve special or repeated emphasis: (1) the manner in which New Mexico's complete abolition of par value differs from comparable provisions in the Model Business Corporation Act (the "MBCA"); (2) the renewed utility of the *de facto corporation* doctrine; and (3) the conditional nature of the applicability of the new shareholder majority vote provisions. The first two areas are of special concern because they depart from comparable provisions in both the 1980 amendments to the MBCA from which they were derived as well as the Revised MBCA of 1984[4] (the "1984 Revised MBCA"). The third area describes pitfalls waiting for the unwary practitioner who relies on complete cross-indexing of related statutory provisions in the New Mexico Amendments.

The New Mexico cases reviewed fall into three groups. In the first group, the courts clarify existing law on the disregard of the corporate entity to impose liability for corporate obligations on shareholders. The second group develops New Mexico law pertaining to the rights of minority shareholders challenging the conduct of management controlled by majority shareholders. The final group involves the clarification of existing law on the personal jurisdiction of New Mexico courts over foreign corporations under the New Mexico Long-Arm Statute. This discussion, primarily intended for corporate practitioners, should prove useful to anyone desiring information about the state of corporate law in New Mexico.

*Associate Professor of Law, University of New Mexico School of Law. The author would like to thank Dean Theodore Parnall for his very helpful comments on earlier drafts of this article.

1. 1983 N.M. Laws, ch. 304, 1983 N.M. Laws ch. 31, 1983 N.M. Laws ch. 67.
2. N.M. STAT. ANN. §§ 53-11-1 through 53-18-12 (Repl. Pamp. 1983).
3. 14 N.M. L. REV. 371 (1984).
4. REV. MODEL BUSINESS CORP. ACT (1984).

I. TROUBLE SPOTS UNDER THE 1983 AMENDMENTS

A. The Abolition of Par Value: Beyond the MBCA

The 1980 amendments to the MBCA were intended to abolish the concept of par value and eliminate the artificiality of the legal capital and distribution provisions.[5] These objectives were accomplished in part by amending the appropriate sections to delete all but one of the references to par value.[6] Section 54(3) of the MBCA, permitting the inclusion of provisions on par value in the articles of incorporation, became the sole MBCA reference to what had been the lodestar of the law of legal capital. The New Mexico Amendments went beyond the amended MBCA and deleted *all* references to the term "par value," including the section 54(3) equivalent, from the New Mexico Business Corporation Act. As an alternative to par value the New Mexico Amendments permit the inclusion in the articles of incorporation of provisions setting forth the "minimum consideration" to be paid for shares.[7]

On its face, the "minimum consideration" language, while a deviation from the MBCA, seems innocuous and consistent with the abrogation of the concept of par value. Moreover, the inclusion of the "minimum consideration" provision might have been intended to provide symmetry between section 53-12-2(B)(3), the New Mexico version of section 54(3) of the MBCA, and section 53-11-18 of the Act which authorizes the issuance of shares "for such consideration as shall be authorized by the board of directors establishing a price . . . or a minimum price . . ." subject to restrictions in the articles of incorporation. Under such reasoning, section 53-12-2(B)(3) merely provides for the inclusion in the articles of incorporation of the restrictions authorized in section 53-11-18.

Unfortunately, the variance of section 53-12-2(B)(3) from its equivalent in both the 1980 amendments to the MBCA and the 1984 Revised MBCA raises several questions for existing New Mexico corporations and newly chartered New Mexico corporations desiring to use par value. The decision by the drafters of the 1980 MBCA amendments to permit the inclusion of provisions on par value was not a mere accommodation of practitioners reluctant to change.

5. A Report of Committee on Corporate Laws, *Changes in the Model Business Corporation Act—Amendments to Financial Provisions*, 34 BUS. LAW. 1867-69 (1979); B. MANNING, A CONCISE TEXTBOOK ON LEGAL CAPITAL 165-66 (2d ed. 1981).

6. The deletion of the term "par value" was not equivalent to the establishment of universal "no-par" shares. Even no-par shares are subject to legal capital requirements. However, the portion of the consideration paid for them allocated to stated capital is determined by the board of directors and, consequently, is not required to be included in a public document. Under the 1980 amendments to the MBCA, no-par shares are irrelevant since none of the consideration is treated as legal capital.

7. N.M. STAT. ANN. § 53-12-2(B)(3) (Repl. Pamp. 1983).

Inclusion of the provisions was permitted for two significant reasons. First, all corporations in existence on the date of adoption of the 1980 Amendments would have provisions on par value in their articles of incorporation which would continue to exist although the term "par value" is without legal effect.[8] Second, a corporation may attempt to qualify to do business in another jurisdiction in which franchise taxes are computed on the basis of par value.[9] Other jurisdictions that have abolished par value but permit the inclusion of provisions in articles of incorporation either expressly delineate the purposes for which it may be included or follow the MBCA section 54(3) language.[10] The New Mexico Amendments, by excluding all references to par value, fail to take account of these concerns. More significantly, they may also resurrect watered stock[11] problems that the deletion of "par value" in the MBCA was designed at least in part to eliminate.[12]

As noted above, the New Mexico Amendments use the term "minimum consideration" in lieu of "par value" in section 53-12-2(B)(3). All New Mexico corporations formed prior to the effective date of the 1983 Amendments ("Pre-amendment Corporations") include provisions in their articles of incorporation for "par value" or "no par value" stock.[13] The effect of such provisions is now unclear under New Mexico law. Many corporations formed after the effective date of the New Mexico Amendments ("Post-amendment Corporations") have, as a practical matter, frequently included provisions for "par value" or "no par value" stock in their articles of incorporation.[14] The effect of such provisions is also unclear. The lack of statutory guidance leaves room for too many speculative arguments: for example, the validity of shares issued, rights of

8. *See supra* note 5.

9. *Id.* The amount of the franchise tax may be determined by multiplying the stated capital of the corporation by the franchise tax rate.

10. CAL. CORP. CODE §§ 205, 409 and 418 (West 1977) (not based upon 1980 MBCA amendments but expressly providing that par value may be used for the purpose of determining any tax or franchise fee computed on the basis of par value and establishing par value at $1.00 per share); MINN. STAT. ANN. §§ 302A.401, 302A.405 (West 1985) (expressly permitting par value for purpose of determining franchise taxes and fees but establishing par value at $0.01 per share); ILL. ANN. STAT. ch. 32, §§ 6.25, 6.30, 6.35 (Smith-Hurd 1982); MONT. CODE ANN. §§ 35-1-605, -606, -610 (1985); VA. CODE ANN. § 13.1-643 (Repl. Vol. 1985); WASH. REV. CODE ANN. §§ 23A.08.150, .160, 23A.08.190. *See also* REV. MODEL BUSINESS CORP. ACT § 2.02(B)(2)(iv)(1984).

11. Watered stock is commonly thought of as stock issued for less than par value but technically it is any stock issued for less than the amount of consideration required by law.

12. *See supra* note 5.

13. Prior to the 1983 Amendments, the Act required a corporation's articles of incorporation to include a provision establishing the par value of shares or declaring all shares to be without par value. N.M. STAT. ANN. § 53-12-2(A)(4) (1978) (amended 1983).

14. The Corporations Department of the State Corporation Commission confirmed that it continues to accept articles of incorporation containing par value provisions. The justification for this administrative decision is that other states use par value to compute franchise taxes.

corporate creditors, and the obligation of shareholders, to afford any cold comfort to the cautious practitioner.

Prior to the New Mexico Amendments, the Act, following the MBCA, addressed watered stock in two statutory provisions. Section 53-11-25,[15] based upon a breach of contract theory, provided for liability for purchasers of shares from the corporation who tendered less than the full consideration agreed upon. The second section, 53-11-18,[16] was based upon a statutory obligation theory and prohibited the issuance of shares for consideration in an amount less than the par value. Unlike section 53-11-25, however, section 53-11-18 did not specify the legal consequences of a failure of the shareholder to pay in at least par value.

The origins of watered stock doctrine are rooted in the common law rather than statutes. Watered stock remedies are equitable in nature and several theoretical bases have been articulated in the cases, including the contract and statutory obligation theories. Thus, even though the drafters of the 1980 Amendments did not so intend, it was still possible for a watered stock problem to arise under the MBCA using one of the various traditional watered stock theories. For example, in section 18 of the MBCA, as amended by the 1980 Amendments, the board of directors was authorized to establish a "minimum price" per share subject to restrictions in the articles of incorporation. Notwithstanding the intentions of the drafters of the 1980 Amendments, watered stock liability arguably might arise whenever a board of directors established a "minimum price." Watered stock would then involve stock issued for consideration with a value less than the minimum price set by the board of directors. Into this maze stepped the New Mexico Amendments, which not only included the "minimum price" language in the New Mexico version of section 18[17] of the MBCA, but also substituted the "minimum consideration" language in the New Mexico equivalent of section 54(3) of the MBCA.[18]

The drafters of the 1984 Revised MBCA deleted the minimum price language in a complete revampment of the shareholder pay-in provisions.[19] In section 6.21, they also provided for a mandatory determination of the adequacy of consideration by the board of directors.[20] That determination is conclusive with respect to whether shares are validly issued, fully paid, and nonassessable.[21] If watered stock problems remain under

15. N.M. STAT. ANN. § 53-11-25 (Repl. Pamp. 1983) follows MODEL BUSINESS CORP. ACT § 25 (1969).

16. N.M. STAT. ANN. § 53-11-18 (Repl. Pamp. 1983) follows MODEL BUSINESS CORP. ACT § 18 (1969) (amended 1980).

17. MODEL BUSINESS CORP. ACT § 18 (1969)(amended 1979).

18. MODEL BUSINESS CORP. ACT § 54(3) (1969)(amended 1979).

19. REV. MODEL BUSINESS CORP. ACT § 6.21. *See* deviation between official version and version contained in REV. MODEL BUSINESS CORP. ACT (Exposure Draft 1983).

20. REV. MODEL BUSINESS CORP. ACT § 6.21 (1984).

21. *Id.*

the 1984 Revised MBCA, it is not because the provisions of the MBCA may be construed to establish such liability.[22]

In light of the history and complexity of watered stock issues, the New Mexico Amendments create unnecessary ambiguities. The preferable approach would be to follow the lead of the 1984 Revised MBCA and eliminate entirely the concept of minimum consideration from the statutory schema as well as providing for the optional use of par value for purposes specified by the drafters of the 1980 amendments to the MBCA and the 1984 Revised MBCA.

B. A Continuing Need for the "De Facto" Doctrine?

The combination of sections 56 and 146 of the MBCA was intended to eliminate the need for the "de facto corporation" and "corporation by estoppel" doctrines.[23] Under section 56, corporate existence begins upon the issuance of the certificate of incorporation;[24] section 146 imposes joint and several liability on "all persons who assume to act as a corporation without authority . . . ."[25] Prior to the New Mexico Amendments, these provisions were codified in sections 53-12-4 and 53-18-9 of the Act. Accordingly, in New Mexico as under the MBCA, there could be little tolerance for the argument that persons should be treated as though they were operating in the corporate form even though no certificate establishing a corporation as a *de jure* entity had been issued. The New Mexico Amendments changed section 53-12-4 to make the date of *delivery of the articles of incorporation to the filing office* rather than the *date of issuance of the certificate of incorporation* the moment that *de jure* corporate existence begins.[26] This change in section 53-12-4 was intended to alleviate certain administrative problems of the State Corporation Commission.[27] However, amended section 53-12-4 establishes a period of uncertainty from the date of filing to the date of issuance of the certificate or notice of rejection.[28] The State Corporation Commission must give notice of rejection within 15 days, but presumably such notice need only

22. It may be theoretically impossible to abrogate watered stock liability completely. Statutory schema generally do not prevent a corporation from including minimum consideration provisions in its articles of incorporation. Nor do they preclude a board of directors from establishing minimum consideration terms for a specific issuance of shares. Any time the corporation or the board of directors takes such action, watered stock liability may arise based upon common law doctrines.

23. MODEL BUSINESS CORP. ACT §§ 56, 146 official comments (1969).

24. MODEL BUSINESS CORP. ACT § 56 (1969) (amended 1984).

25. MODEL BUSINESS CORP. ACT § 146 (1969) (amended 1984).

26. N.M. STAT. ANN. § 53-12-4 (Repl. Pamp. 1983).

27. *See supra* note 3, at 392-93.

28. N.M. STAT. ANN. § 53-12-4 (Repl. Pamp. 1983) cross-references N.M. STAT. ANN. § 53-18-2 (Repl. Pamp. 1983). The latter section provides a fifteen day period in which the State Corporation Commission has to give notice that it has disapproved any document, including but not limited to articles of incorporation, that may not be filed without the Commission's approval.

be placed in the mail.[29] Since actual receipt of notice of rejection would not occur until after the 15 day period, the period of uncertainty could extend well beyond 15 days. If the proposed officers and directors of the corporation conduct business on behalf of the corporation during the period of uncertainty, they may be personally liable under section 53-18-9 unless the courts recognize the doctrines in New Mexico.

If the filing office accepts the articles of incorporation and issues the certificate, corporate existence begins on the date of delivery to the filing office. Thus, personal liability questions arising out of transactions during the period of uncertainty will be rendered moot for most corporations. The counterpart to section 146 in the 1984 Revised MBCA,[30] if adopted and used in conjunction with section 53-12-4 of the Act, would provide relief from liability without resort to the doctrines. Section 2.04 of the 1984 Revised MBCA imposes personal liability only on those persons who assume to act as or on behalf of a corporation *knowing* that there was no incorporation.[31]

C. The Shareholder Majority Vote Trap

The New Mexico Amendments also contain a trap in which even a careful practitioner may be ensnared. Most of the changes of the New Mexico Amendments, such as those abolishing legal capital concepts and establishing new standards for measuring the propriety of distributions to shareholders, apply to all business corporations chartered under New Mexico law, including Pre-amendment Corporations. This result is clear not only because the Act no longer contains any provisions on par value or utilizing the same to compute the propriety of distributions, but also because section 53-18-10, as amended, provides that the Act applies to all existing corporations.[32]

If section 53-18-10 were the sole provision on the applicability of the New Mexico Amendments to Pre-amendment Corporations, no problem would have been created. The New Mexico Amendments, however, contained a second provision governing the applicability to Pre-amendment Corporations of changes to other statutory provisions, including, but not limited to, sections 53-13-2, 53-14-3, 53-15-2, and 53-16-3, which prescribe minimum shareholder vote requirements for the approval of fundamental corporate transactions such as mergers, sales of assets, amendments to articles and dissolution.[33] Under those sections,[34] the minimum vote

29. N.M. STAT. ANN. § 53-18-2 (Repl. Pamp. 1983) refers to the "giving" of notice by the State Corporation Commission rather than receipt by the person entitled to receive notice.

30. *See* REV. MODEL BUSINESS CORP. ACT § 2.04 (1984).

31. *Id.*

32. N.M. STAT. ANN. § 53-18-10 (Repl. Pamp. 1983).

33. *Id.* at §§ 53-13-2, 53-14-3, 53-15-2, 53-16-3.

34. *Id.*

required for approval of these transactions was lowered from two-thirds to a simple majority. Section 53-18-6.1 requires Pre-amendment Corporations to amend their articles of incorporation in order to take advantage of the lower voting threshold.[35] Any such amendment to a corporation's articles of incorporation would require the higher minimum vote requirement of prior law. A provision such as 53-18-6.1 was evidently deemed desirable because the higher minimum vote may have been a feature of the balance of control agreed to by shareholders in a Pre-amendment Corporation.

Unfortunately, neither section 53-18-10 nor section 53-18-6.1 cross-references the other. If counsel, concerned about the applicability of the lower voting requirements to Pre-amendment Corporations, looks for an express statutory provision on applicability to existing corporations and finds section 53-18-10 first, counsel could conclude erroneously (but perhaps reasonably) that the lower voting requirements of the New Mexico Amendments apply. The effect of counsel's erroneous conclusion may be the approval of corporate action with less than the statutorily prescribed vote. Under such circumstances such corporate action should be invalid, absent other compelling factors.[36]

II. RECENT NEW MEXICO DECISIONS

A. Corporate Law

1. Disregarding Corporateness

That a corporation may be formed to shield the owners from personal liability is a venerable principle of American jurisprudence as well as an important incentive to private sector economic development. This principle is founded upon the fiction that the corporation is a legal persona separate and distinct from its owners. It is also settled that the courts may disregard the corporate entity under compelling circumstances. The New Mexico appellate courts recently decided three cases that illuminate New Mexico law on the separate entity status of the corporation and on the disregard of the corporate entity in the context of affiliated or subsidiary corporations. The burden continues to be a difficult one: those requesting that the court disregard the corporate entity lost all three cases.

Boothe Financial Corp. v. Loretto Block, Inc.,[37] involved a lease to a tenant corporation and an option to purchase the underlying property held by an affiliated party, an Oklahoma limited partnership. The option was

35. *Id.* at § 53-18-6.1.

36. A court is not precluded from applying equitable precepts to a dispute over duly and properly approved corporate action. Thus, a court may be influenced by the financial impact of the action on the corporation, third parties and shareholders of the corporation.

37. 97 N.M. 496, 641 P.2d 527 (Ct. App. 1982).

obtained by the partnership after the creation of the lease but before its acquisition of the tenant corporation.[38] The partnership exercised the option and sought possession of the leased premises during the period between the termination of the lease and the closing of the purchase transaction pursuant to the exercise of the option.[39] The partnership asked the court to disregard the fact that it was an entity legally separate and distinct from the tenant corporation.[40] The partnership sought to avail itself of the rule that when a tenant in possession exercises an option to purchase, the relationship is transformed from a landlord-tenant relationship to a vendor-purchaser relationship such that the purchaser has equitable title and is entitled to remain in possession.[41]

The trial court refused to disregard the separate entity status of the tenant corporation and the partnership.[42] The court ruled in favor of the lessor-optionor on the grounds that the option was held by the partnership which was not the same legal entity as the lessee under the lease.[43] The New Mexico Court of Appeals affirmed on two grounds. First, the option tenant in possession rule only applies where the option is contained in the lease agreement.[44] Second, the rule that a corporation is a separate entity from its stockholders applies even where a sole shareholder owns all the stock.[45] The limited partnership, accordingly, did not fall within the scope of the option tenant in possession rule because it was not the legal entity with tenant status and the option was not a part of the lease agreement.[46]

The strict adherence to the separate entity approach of *Boothe Financial Corp.* should be a lesson for attorneys dealing with corporate lessees. This caveat is appropriate for lawyers whether representing the landlord or tenant. The pitfalls are particularly treacherous where option rights, transfer of the leasehold or the acquisition of a lessee is involved. Important rights and obligations may depend upon which entity is the formal party to a lease.

One theory which the courts have relied on to disregard the corporate entity is the "alter ego" theory. In *Cruttenden v. Mantura,*[47] the New Mexico Supreme Court reiterated the rule that subsidiary and parent corporations are ordinarily treated as strictly separate and independent

38. *Id.* at 498, 641 P.2d at 529.
39. *Id.*
40. *Id.* at 499, 641 P.2d at 530.
41. *Id.*
42. *Id.*
43. *Id.* at 498, 641 P.2d at 529.
44. *Id.* at 499, 641 P.2d at 530. The option was created in a separate document.
45. *Id.*
46. *Id.*
47. 97 N.M. 432, 640 P.2d 932 (1982).

entities. However, a subsidiary may be deemed the alter ego of the parent corporation where the control by the parent "is so complete as to render the subsidiary an instrumentality of the parent."[48]

The New Mexico Supreme Court articulated a ten-factor test to determine whether a subsidiary corporation is the alter ego of the parent.[49] As the court pointed out, all of the factors need not be present to establish an alter ego but a combination of several factors is required. This is important because several of the ten factors are commonly found in parent-subsidiary arrangements.[50] The court, however, did not indicate which factors or combinations thereof have greater weight. Thus, the factors, while useful, epitomize the historical difficulty the courts have had articulating meaningful objective standards for determining when the corporate form should be disregarded.[51]

Harlow v. Fibron[52] presents a corporate creditor's attempt to "pierce the corporate veil" to impose liability on a controlling shareholder and two other corporations affiliated with the controlling shareholder. Harlow purchased defective pipe from Kinetics, Inc. and obtained a judgment against it.[53] After the judgment was obtained, all of the outstanding shares of Kinetics were sold to Fibron Corporation without Harlow's knowl-

48. *Id.* at 434, 640 P.2d at 934.

49. The factors are:

(1) The parent corporation owns all or majority of the capital stock of the subsidiary.
(2) The parent and subsidiary corporations have common directors or officers.
(3) The parent corporation finances the subsidiary.
(4) The parent corporation subscribes to all the capital stock of the subsidiary or otherwise causes its incorporation.
(5) The subsidiary has grossly inadequate capital.
(6) The parent corporation pays the salaries or expenses or losses of the subsidiary.
(7) The subsidiary has substantially no business except with the parent corporation or no assets except those conveyed to it by the parent corporation.
(8) In the papers of the parent corporation, and in the statements of its officers, 'the subsidiary' is referred to as such or as a department or division.
(9) The directors or executives do not act independently in the interest of the subsidiary but take direction from the parent corporation.
(10) The formal legal requirements of the subsidiary as a separate legal entity are not observed.

Id. at 434-35, 640 P.2d at 934-35.

50. Many parent-subsidiary arrangements involve common officers and directors. Moreover, parent corporations are by definition the primary source of capital financing for a subsidiary and many subsidiaries are wholly owned by a single parent corporation. That the case law lists these conditions as factors to be considered emphasizes the lack of coherency in justifying the imposition of veil-piercing remedies. One reason for the incoherency is that the law expressly permits the formation of a corporation to limit liability. However, the courts have been far less reluctant to nail parent corporations than individual shareholders. Hamilton, *The Corporate Entity,* 49 TEX. L. REV. 979, 992-93 (1971).

51. HAMILTON, CASES AND MATERIALS ON CORPORATIONS 227, notes 1 and 2 (3d. ed. 1986).

52. 100 N.M. 379, 671 P.2d 40 (Ct. App. 1983).

53. 100 N.M. at 381, 671 P.2d at 42.

edge.[54] When all the assets (except the Kinetics shares) of Fibron were destroyed by fire, Harlow joined Midwest Equipment Company, Mid-Tex Construction Company and James Brock, the controlling shareholder of Kinetics before it was acquired by Fibron.[55] Harlow claimed that Midwest, Mid-Tex and Brock were alter egos of Kinetics.[56]

The apparent basis of the plaintiff's claim against Brock was that, as the founder and controlling shareholder of Kinetics, he had undercapitalized Kinetics by causing it to incur an initial indebtedness to himself.[57] Furthermore, he had personally transferred funds from time to time to Kinetics to pay its creditors.[58] Harlow's argument that Midwest and Mid-Tex were alter egos of Kinetics was based upon an analysis of the *Cruttenden* factors, at least two of which were present: (1) common officers and directors; and (2) commingling of finances and other matters. First, Brock served as the chief executive officer and president of each corporation.[59] Second, Midwest and Mid-Tex transferred money to Kinetics, paid all of Kinetics' expenses and handled Kinetics accounting on their books.[60] However, the corporations did not own any Kinetics stock, and except for the payment of expenses and handling of financial matters, the corporations were not related to Kinetics.[61]

The trial court, respecting the separate nature of the entities, rendered a judgment in favor of the defendants, and the New Mexico Court of Appeals affirmed, holding that a piercing the corporate veil claim is not complete merely by alleging alter ego.[62] The court, relying upon Krendl and Krendl, *Piercing the Corporate Veil: Focusing the Inquiry*,[63] then articulated the requisite elements of the claim:[64] instrumentality, improper purpose, and proximate causation.[65] The court stated that New Mexico cases refer to the instrumentality theory as the alter ego doctrine.[66] Instrumentality in the subsidiary or affiliated corporation context was explained in terms of which entity's purposes were furthered and of domination:

> A plaintiff must prove that the subsidiary or other subservient corporation was operated not in a legitimate fashion, to serve the valid

54. *Id.*
55. *Id.*
56. *Id.*
57. *Id.*
58. *Id.*
59. *Id.*
60. *Id.*
61. *Id.*
62. *Id.* at 382, 671 P.2d at 43.
63. 55 DENVER L. J. 1 (1978).
64. The specific elements of a piercing the corporate veil action may vary by jurisdiction. *See supra* notes 67-68.
65. *Harlow*, 100 N.M. at 382, 671 P.2d at 43.
66. *Id.*

> goals and purposes of that corporation but that it functioned under the domination and control and for the purposes of some dominant party.[67]

The quoted language, although frequently used by courts and commentators, encompasses many ordinary parent-subsidiary relationships. Nevertheless, the law permits corporations to be formed for the purpose of limiting the personal liability of owners, and courts are reluctant to disregard the corporate entity.

The improper purpose element is a product of such reluctance. A plaintiff has only satisfied one element with a showing of alter ego. Courts will not deviate from a strict separate entity approach unless the corporate entity has been used for an improper purpose. The concept resembles but is not identical to the fraudulent purpose requirement used in New York and other jurisdictions.[68] Some jurisdictions require a strong showing of improper purpose when the imposition of shareholder liability is requested but less when the question involves matters such as personal jurisdiction.[69]

The New Mexico Court of Appeals did not discuss the nature of an "improper purpose" because the trial court had found no "improper, inequitable, unfair, illegal, unjust or fraudulent act or actions on the part of"[70] Brock, Midwest and Mid-Tex. That finding was supported by their advancement of more than $1,000,000 to Kinetics, a business that was a losing venture at the time.[71] The court, emphasizing the equitable nature of the remedy, indicates that a different result may have been warranted if Brock or the corporations had taken money out of Kinetics or raided its assets.[72]

Both *Cruttenden* and *Harlow* involve the alter ego doctrine in parent or affiliated corporation settings. *Cruttenden* and *Harlow* serve as a reminder that corporate creditors should deal on a formal basis with subsidiary or affiliated corporations, seeking formal guarantees when the financial circumstances or continued well-being of the corporation that is the formal party to the transaction is questionable. When the dealings become as informal and as intertwined as they did in *Harlow,* creditors and parties related to the corporate obligor may find themselves in the midst of expensive litigation that might have been avoided.

---

67. *Id.* (citing Krendl and Krendl, *Piercing the Corporate Veil: Focusing the Inquiry,* 55 DENVER L. J. 1, 15 (1978)).

68. Marine Midland Bank, N.A. v. Miller, 664 F.2d 899 (2d Cir. 1981); Walcholsky v. Carlton, 18 N.Y.2d 414, 276 N.Y.S.2d 585, 223 N.E.2d 6 (1966).

69. *Marine Midland Bank,* 664 F.2d 899 (applying New York law); *see also* State v. MacPherson, 62 N.M. 308, 309 P.2d 981 (1957) (applying New Mexico law).

70. *Harlow,* 100 N.M. at 383, 671 P.2d at 44.

71. *Id.*

72. *Id.*

B. Challenges of Minority Shareholders to Majority Control

Minority shareholders who objected to the management of the majority fared no better during the survey period than plaintiffs who requested the courts to disregard the corporate entity. *Schwartzman v. Schwartzman Packing Co.*[73] involved a dispute between family members in a closely-held corporation. The minority shareholders filed suit against the corporation and the majority shareholders, complaining of conduct oppressive to the minority shareholders and injurious to the corporation.[74]

Prior to the trial, the corporation had agreed to allow a reasonable inspection of the corporate books and records.[75] The minority shareholders sent teams of three to six accountants during normal business hours to examine the corporate books and records.[76] When the company's business was disrupted, the inspection was restricted to nonbusiness hours.[77]

The minority shareholders objected to the restriction and moved the trial court to compel the company to permit 8 a.m. to 5 p.m. inspections.[78] The trial court denied the request and ordered one additional day for the completion of the examination.[79] On appeal, the minority shareholders contended that the limits placed on their examination of the books and records was unlawful.[80]

Although the case was one of first impression in New Mexico, it did not present any novel questions on the issue of the right to inspect. However, *Schwartzman* demonstrated the inherent tensions concomitant with a shareholder's right to inspect corporate books and records.[81] On the one hand, a shareholder is an owner entitled to know what his or her business is doing. On the other hand, the corporation has a business to operate, and inspections require time and space that can interfere with that operation. The right to inspect therefore is not an unbridled one; and a shareholder may not demand unreasonable access to corporate books and records.

The New Mexico Supreme Court upheld the trial court and clarified the scope of the right to inspect in New Mexico. The Court said that a shareholder's right to inspect corporate books and records at reasonable times and places[82] was recognized at common law and exists independently of statute.[83] Moreover, the court noted that the MBCA provisions[84]

73. 99 N.M. 436, 659 P.2d 888 (1983).
74. *Id.* at 438, 659 P.2d at 890.
75. *Id.*
76. *Id.*
77. *Id.*
78. *Id.*
79. *Id.* at 439, 659 P.2d at 891.
80. *Id.* at 438, 659 P.2d at 890.
81. *Id.* at 439-40, 659 P.2d at 890-91.
82. *Id.* at 439, 659 P.2d at 891.
83. N.M. STAT. ANN. § 53-11-50 (Repl. Pamp. 1983).
84. MODEL BUSINESS CORP. ACT § 52 (1969).

on which section 53-11-50 is based have been construed to enlarge, rather than limit, the common law right to inspect.[85]

Whether the Act expanded or limited the common law right to inspect was not in question since the corporation conceded that the minority shareholders had a right to inspect the books and records.[86] Nor did the corporation argue that the minority shareholders could not take substantial amounts of time or bring in expert representatives to assist in the inspection. The corporation argued that the right to inspect was not an arbitrary one entitling plaintiffs to disrupt the day-to-day business of the company for long periods of time.[87]

The New Mexico Supreme Court correctly rejected the minority shareholders' claim that they had an unlimited right to inspect without regard to the hardship imposed upon the corporation. Section 53-11-50 specifically prescribes that the examination be "at any reasonable time".[88] In discussing reasonableness, the court made two noteworthy points. First, reasonableness apparently may be measured by the extent to which an inspection does not unduly interfere with the regular business of the company.[89] A requesting shareholder need not accept the company's time frame for the inspection and could insist upon another time as long as the examination does not unduly interfere with the carrying on of the company's business. Second, reasonableness is to be determined on a case by case basis.[90] Trial courts have discretion in determining when and in what manner the right to inspect may be exercised.[91]

The minority shareholders also sought several other remedies from the court. First, they sought to wrest control from the majority with the appointment of a master and receiver.[92] If they had been successful with that strategy, their victory may have been pyrrhic as the expenses of a master or receiver can consume a considerable amount of the corporate assets. In any event, the remedy is an extraordinary equitable remedy and rarely granted.[93]

Second, they asked the court to dissolve the corporation on the basis of allegedly oppressive conduct on the part of the corporation and the

85. Bishop's Estate v. Antilles Enterprises, 252 F.2d 498 (3d Cir. 1958); Tucson Gas & Elec. Co. v. Shantz, 5 Ariz. App. 511, 428 P.2d 686 (1967); Leisner v. Kent Investors, Inc., 62 Misc.2d 132, 302 N.Y.S.2d 293 (1970); Meyer v. Ford Indus., 272 Or. 531, 538 P.2d 353 (1975); Texas Infra-Red Radiant Co. v. Godwin, 397 S.W.2d 491 (Tex. Civ. App. 1965)(writ ref'd n.r.e).

86. *Schwartzman*, 99 N.M. at 439, 659 P.2d at 891.

87. *Id.*

88. N.M. STAT. ANN. § 53-11-50 (Repl. Pamp. 1983).

89. *Schwartzman*, 99 N.M. at 441, 659 P.2d at 893.

90. *Id.*

91. *Id.*

92. *Id.*

93. 3A W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 1039 (Rev. Perm. 1979). The remedy is so extremely expensive that the transactions costs are usually prohibitive. POMEROY'S EQUITY JURISPRUDENCE § 1484 (4th ed. 1919).

controlling shareholders.[94] Although that remedy is also extraordinary and rarely granted, it has an express statutory basis.[95] Plaintiffs also asked for pecuniary damages and restitution to the corporation of allegedly misappropriated assets.[96] The trial court dismissed some claims and granted summary judgment to the defendants on the other claims and the supreme court affirmed.[97]

Dilaconi v. New Cal Corp.[98] presents another instance where minority shareholders in a closely-held family corporation complained of abuse by the majority shareholders. The minority shareholders sought a potpourri of remedies including an accounting, restoration of corporate assets, injunctive relief, removal of corporate officers, appointment of a receiver and liquidation of the corporation.[99] The principal shareholder, his wife and son were directors of and, respectively, president, secretary and vice president of the corporation.[100] Sharing a characteristic of many closely-held corporations, New Cal was managed very informally and the corporation's affairs and the principal shareholder's personal business were intermingled.[101] Accordingly, either the directors or the principal shareholder, acting in his capacity as an officer of the corporation, approved several transactions between the corporation and the principal shareholder or for his benefit.[102]

While a previous survey article discussed the court of appeals' result,[103] this Article will examine the majority shareholder's successful use of the business judgment rule to defend against the minority shareholders' claims that the directors and officers breached their fiduciary duties to the corporation. The business judgment rule subjects the actions of directors to judicial scrutiny, but operates to shield the decisions of directors from second guessing by the courts. The business judgment rule is applied where the directors act (1) within their authority on a reasonable basis, (2) in good faith, and (3) with an honest belief that they were acting in the best interests of the corporation.[104]

Commentators generally agree that the business judgment rule is inapplicable where directors have a conflict of interest.[105] Others suggest

94. *Schwartzman*, 99 N.M. at 438, 659 P.2d at 890.
95. N.M. STAT. ANN. § 53-16-16 (Repl. Pamp. 1983).
96. *Schwartzman*, 99 N.M. at 438, 659 P.2d at 890.
97. *Id.*
98. 97 N.M. 782, 643 P.2d 1234 (Ct. App. 1982).
99. *Id.* at 783, 643 P.2d at 1235.
100. *Id.*
101. *Id.* at 783-87, 643 P.2d at 1235-39.
102. *Id.*
103. Johnson, *Commercial Law*, 14 N.M. L. REV. 45, 60 (1984).
104. *Dilaconi*, 97 N.M. at 788, 643 P.2d at 1240.
105. H.G. HENN & J.R. ALEXANDER, LAWS OF CORPORATIONS §§ 242-243 (1983); R. CLARKE, CORPORATE LAW § 3.5 (1986).

that the business judgment rule is applicable unless the directors are tainted by a disabling conflict.[106] It is not always clear whether a conflict rises to the level of being "disabling". For example, in *Sinclair Oil Corp. v. Levien*,[107] one of the leading cases exemplifying this enigma, the Delaware Supreme Court held that the interested directors of a subsidiary corporation were entitled to use the business judgment rule with respect to transactions which benefited all shareholders or which were within the best interests of the subsidiary corporation.[108] However, the court stated that directors could not use the defense with respect to transactions that benefited only the parent corporation.[109]

Even if the directors in *Dilaconi* possessed a disabling conflict of interest, the result reached by the application of the business judgment rule was consistent with prior New Mexico case law[110] applicable to such transactions and the law of several other jurisdictions.[111] The significance of which standard is applicable has to do with the degree of scrutiny required of a court. The business judgment rule connotes judicial deference and minimal scrutiny.

Interestingly, Judge Sutin argued in his dissent that transactions between a corporation and interested directors should be subjected to careful scrutiny.[112] However, he did not argue that the review provided by the business judgment rule was insufficient. Instead he took the position that the trial court did not discharge, and the court of appeals by its reliance on the trial court did not exact, the necessary degree of review.[113] The majority, however, may have been convinced that the trial court did subject the transactions to exacting scrutiny and found that the directors and officers satisfied their burden of proof.[114] The excerpt from the trial court's findings evokes images of a referee vigorously making a call he is sure will be controversial so that the contestants and the higher authorities will know he is certain of what he saw.[115] Perhaps the most important finding the

106. *See e.g.* Arsht, *The Business Judgment Rule Revisited*, 8 HOFSTRA L. REV. 93, 111-16 (1979); Steinberg, *Some Thoughts on the Regulation of Tender Offers*, 43 MD. L. REV. 240, 242 (1984).

107. 280 A.2d 717 (Del. 1971).

108. *Id.* at 720.

109. *Id.* at 723.

110. G O S Cattle Co. v. Bragaw's Heirs, 38 N.M. 105, 109, 28 P.2d 529, 531 (1933). In fact, the majority in *Dilaconi* acknowledged that rigorous scrutiny was required, notwithstanding its application of the business judgment rule.

111. *See generally* H. HENN AND J. ALEXANDER, LAWS OF CORPORATIONS §§ 235-38 (3d. ed. 1983).

112. *Dilaconi*, 97 N.M. at 791, 643 P.2d at 1243.

113. *Id.*

114. *Id.* at 788-91, 643 P.2d at 1240-43.

115. The trial court made, among others, the following findings of fact:

> 5. The major problem with the business relation of the parties is, and has been, the fact that the plaintiffs are minority stockholders in a closely held corporation;

trial court made was that the dispute was nothing more than a fundamental disagreement over the operations of the corporation.[116]

DiIaconi and *Schwartzman* illustrate that the corporate governance norm is majority rule. The minority shareholder must be able to show more than a dispute over the management, direction and business policies of the corporation. If the minority shareholder wishes to alter the norm, he or she must do so at the time of buying into the corporation.[117] A court will not provide relief if it finds that a subsequent disagreement over management is the heart of the dispute.

C. *Foreign Corporations*

Corporate counsel are frequently asked to render "doing business" opinions to foreign corporations with respect to business transactions that occur within New Mexico. The typical opinion contemplates whether the transactions constitute doing business for the purposes of: (1) qualification as a foreign corporation under the New Mexico Business Corporation Act; (2) state taxation of corporate income; and (3) long-arm jurisdiction. The amount of activity required usually varies for each of these issues. Generally, long-arm jurisdiction requires less activity than that which is necessary for either qualification or taxation purposes.[118] *Kathrein v. Park-*

> the majority stockholder has used his controlling interest in the conduct of the business of the corporation, has made decisions as to the incurring of indebtedness, has planned the development of the land, has made sales, and has made business decisions with respect to the manner in which the affairs of the corporation are to be managed. The majority of the business decisions made by the corporation are questioned by and objected to by the minority stockholders. It is the view of the Court that the problem is inherent in the business relationships of the parties and their respective interests in the corporation, and is not a problem capable of resolution by the Court.

Id. at 784, 643 P.2d at 1236.

116. *Id.*

117. A prospective buyer, particularly in the closed corporation context, may have the opportunity to negotiate deviations to the corporate norm in the form of provisions of the articles of incorporation, bylaws and other corporate governance documents and shareholder agreements. If the buyer does not negotiate such terms, then the statutory norm will prevail.

118. N.M. STAT. ANN. § 53-17-1 (Repl. Pamp. 1983) provides that "[n]o foreign corporation shall transact business in this state until it has procured a certificate." Section 53-17-1 also explicitly sets forth eleven categories of transactions that will not constitute doing business thereunder. Several of those factors might independently give rise to personal jurisdiction or subject the corporation to taxation by the State of New Mexico.

N.M. STAT. ANN. § 38-1-16 (1978) provides that "[a]ny person . . . who . . . does any of the acts enumerated in this subsection thereby submits himself or his personal representative to the jurisdiction of the courts of this state as to any cause of action arising from: (1) the transaction of any business within this state . . . ." The New Mexico courts have consistently recognized that the activities that constitute doing business under the long arm statute are not coterminous with the degree of activities required under the foreign corporation qualification statute. They further recognize that a foreign corporation may be subject to the jurisdiction of the New Mexico courts but not required to qualify to do business. Riblet Tramway Co. v. Monte Verde Corp., 453 F.2d 313 (10th Cir. 1972); Winward v. Holly Creek Mills, Inc., 83 N.M. 469, 493 P.2d 954 (1972); *see also* W. FLETCHER, CYCLOPEDIA OF THE LAW OF CORPORATIONS § 8712 (Rev. Perm. Ed. 1979).

N.M. STAT. ANN. § 7-2A-3.A (Repl. Pamp. 1983) imposes a tax on the income of domestic

view Meadows, Inc.[119] and *Aetna Casualty and Surety Co. v. Bendix Control Div.*[120] demonstrate the degree of activity that will constitute doing business for long-arm jurisdiction.

Under the New Mexico long-arm statute,[121] jurisdiction is triggered if the out-of-state defendant engages in one of the specified activities within New Mexico, the cause of action arises out of such activities, and the *International Shoe*[122] due process requirements are satisfied. In *Kathrein,* the injury occurred at the corporation's place of business in Arizona, but the corporation carried on certain activities in New Mexico related to its Arizona operations.[123] The corporation advertised its Arizona alcoholic treatment center in the yellow pages of the Albuquerque telephone directory and sought referrals from a New Mexico resident.[124] In addition, the corporation mailed a brochure to the plaintiff, whose husband was being treated at the facility, inviting her to Arizona to participate in a family program, and telephoned her in New Mexico encouraging her attendance.[125]

The New Mexico Supreme Court held that those activities constituted doing business[126] in New Mexico within the scope of the long-arm statute[127] and were sufficient minimum contacts to satisfy due process considerations.[128] Furthermore, the court held that the invitation mailed to plaintiff was an integral part of the corporation's operations at the Arizona facility so that her injury suffered there arose out of the corporation's activities within New Mexico.[129]

Aetna Casualty serves as a warning to lawyers who issue "doing business" opinions to foreign corporations which sell products to New Mexico residents, even if the sale and delivery take place outside New Mexico. *In Aetna Casualty,* Bendix manufactured parts of a helicopter that crashed in New Mexico injuring a passenger.[130] The passenger's employer and

corporations and foreign corporations "employed or engaged in the transaction of business in, into or from this state on deriving income from any property or employment within this state." In addition, N.M. STAT. ANN. § 7-2A-3.B (Repl. Pamp. 1986) imposes a corporate franchise tax upon domestic and foreign corporations "employed or engaged in the transaction of business in, into or from this state or deriving any income from any property or employment within this state . . . whether engaged in active business or not but having or exercising its corporate franchise in this state." The language is not as open-ended as § 38-1-16, nor as limiting as the language as § 53-17-1. Normally, doing business requirements for taxation statutes are broader than under the corporate qualification statutes. W. FLETCHER, CYCLOPEDIA OF THE LAW OF CORPORATIONS § 8465 (Rev. Perm. Ed. 1979).

119. 102 N.M. 75, 691 P.2d 462 (1984).
120. 101 N.M. 235, 680 P.2d 235 (Ct. App. 1984).
121. N.M. STAT. ANN. § 38-1-16 (1978).
122. Int'l Shoe Co. v. State of Washington, 326 U.S. 310 (1945).
123. 102 N.M. at 76, 691 P.2d at 463.
124. *Id.*
125. *Id.*
126. *Id.* at 77, 691 P.2d at 464.
127. *Id.* at 76-77, 691 P.2d at 463-64.
128. *Id.* at 76, 691 P.2d at 463.
129. *Id.* at 77, 691 P.2d at 464.
130. 101 N.M. at 237, 680 P.2d at 618.

its' insurer then sued, among others, Bendix to recover workman's compensation benefits paid to the passenger.[131] Bendix responded with a motion to dismiss for lack of personal jurisdiction.[132] The Court of Appeals held that the New Mexico long-arm statute was applicable and reversed the trial court's grant of the motion.[133]

The operative provision of the long-arm statute, however, was not the "doing business" clause set forth in section 38-1-16(A)(1)[134] but the tort clause set forth in section 38-1-16(A)(3).[135] The commission of a tort in New Mexico is one of the specified activities giving rise to long-arm jurisdiction.[136] If a negligently manufactured product causes injury in New Mexico, the New Mexico Supreme Court has held that the tort occurs in New Mexico for the purposes of the long-arm statute.[137] Accordingly, if the selling corporation has sufficient other contacts with New Mexico, long-arm jurisdiction may be triggered.

131. *Id.*
132. *Id.* at 238, 680 P.2d at 619.
133. *Id.* at 238, 241, 680 P.2d at 619, 622.
134. N.M. STAT. ANN. § 38-1-16(A)(1) (1978).
135. *Id.* at § 38-1-16(A)(3).
136. *Id.* at § 38-1-16(A)(3).
137. Roberts v. Piper Aircraft Corp., 100 N.M. 363, 670 P.2d 974 (Ct. App. 1983).