IN THE SUPREME COURT OF MISSISSIPPI

CASE NO. 2008-CA-01381

DUDLEY KEENE INDIVIDUALLY AND ON BEHALF OF BROOKHAVEN ACADEMY & SHAREHOLDERS OF BROOKHAVEN ACADEMY — **APPELLANT**

V.

BROOKHAVEN ACADEMY, INC., BROOKHAVEN ACADEMY EDUCATIONAL FOUNDATION, INC., JEFF GATLIN, KEN POWELL, PHIL MCGEE, DEAN SNIDER, AND JOHN DOES 1-11 — **APPELLEE**

REPLY BRIEF OF APPELLANT DUDLEY KEENE

APPEAL FROM THE CHANCERY COURT OF LINCOLN COUNTY, MISSISSIPPI
HONORABLE EDWARD E. PATTEN, JR., PRESIDING

ORAL ARGUMENT IS NOT REQUESTED

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REPLY ARGUMENT

On page 4 of Appellee's Brief, the Appellee's assert that the only complaint was concerning the actions of the Academy's board in their procedure for conducting the vote in 2000. There was not a vote in 2000. This may be a typo, but that is entirely why this lawsuit commenced because from the very beginning certain shareholders of the Academy wanted a vote on these issues and were told that there would not be a shareholders vote on it. The Plaintiffs tried to avoid litigation from the very outset. (R.E. 277). This litigation was commenced because shareholders were repeatedly told that there would not be a vote.

At the eleventh hour, the Defendants now assert that Brookhaven Academy Educational Foundation (hereinafter "Foundation") is not a subsidiary but a stand alone non-profit corporation. The Defendants did not make this argument at the Summary Judgment hearing and focused their argument upon its allegations that the ratification vote concerning the past acts of the directors of Brookhaven Academy, Inc., (hereinafter "Academy") resolved all the problems complained of by Plaintiffs. The only thing mentioned in this regard at said hearing was in

response to a question from Chancellor Patten. At the Summary Judgment hearing, in response to Chancellor Patten's question as to whether the Foundation is a solely owned subsidiary of the Academy, Mr. Lampton stated: "Your Honor, we don't think so. The stockholders are -- Brookhaven -- the foundation is a stand alone corporation. At one time, it was solely owned, but now ... the stockholders of the foundation are members." (T. 32).

From the very outset of this case, it was stated that the Academy would create the Foundation as a subsidiary. Ken Rogers, counsel for the Foundation at said time, stated that it was a subsidiary: "The formation of a wholly-owned nonprofit subsidiary corporation by the corporation is not required to be submitted to the shareholders for approval...". (R.E. 278, 368-69). The letters from counsel state that it will be set up as a subsidiary and the goal would be to obtain fifty-one percent of Academy stock so the Foundation would be the controlling shareholder in the parent company. *Id.*

The Defendants go on to state on page six of Appellee's Brief, without providing any authority, that the non-profit cannot be a subsidiary of the Academy because it is prohibited from generating profits for its members. While it is true that a nonprofit cannot generate profits for its members or shareholders, this is an incorrect statement that the Foundation cannot be a subsidiary of the Academy. General corporate allows for-profit corporations to have nonprofit corporations as subsidiaries and will even allow a nonprofit corporation to form a for-profit corporation. Mississippi corporate law allows a corporation to create a subsidiary even if that subsidiary is a non-profit corporation. *Miss. Code Ann.* § § 79-4-1.01 et seq., 79-4-4.01, 79-11-319, 79-4-11.01.

If as Defendants argue, that the non-profit cannot be a subsidiary because it cannot pass

on profits to its members, then why since the inception of this matter did they try to obtain a controlling interest in the Academy? The board of directors believed that by controlling the Academy that they could clean up all the problems they created and control all the assets.

Further, the Plaintiffs have argued since the inception of this litigation that a membership in the Foundation would only apply to those who were not shareholders of the Academy when the Foundation was formed. As a shareholder in the Academy you would not have to trade in your stock for a membership in the Foundation. By owning the stock when the Foundation was created, you should automatically be a member of the Foundation. It is a principle of corporate law that when a corporation creates a subsidiary that the shareholders also own an equal interest, whatever that might be, in the newly created subsidiary. The idea presented by the Defendants to trade stock for a membership was just a way for them to gain control over the Academy and its assets.

Defendants state the Academy has no share in the Foundation on page six of Appellee's Brief. However, the Academy created the Foundation, and as the Plaintiffs have argued the shareholders are also members of the Foundation. Eight hundred and five (805) Academy shares are asserted to be owned or controlled by the Foundation as evidenced by their vote in December of 2005. The Academy has 2,750 shares, with 1,794 issued and outstanding. The 805 shares alleged to be controlled by the Foundation is less than fifty percent. As such the Foundation does not control the Academy and Plaintiff asserts that the shareholders of the Academy still exercise control.

The Defendants assert, on page 5 of Appellee's Brief, that even if the 805 shares were disqualified from voting, that the resolutions would have still passed overwhelmingly. However,

what the Defendants fail to take into account is that if the shares were disqualified from voting, then the disqualified shares would not be counted at the meeting and therefore a quorum would not have existed. In short, if the shares were disqualified, then the resolutions would have failed due to quorum problems.

While this case does involve a profit and a non-profit as Defendants allude to on page 6 of Appellee's Brief, Plaintiffs would argue that the same duties should extend to the directors of the nonprofit in voting the shares of the Academy. The reasoning behind this is that the Foundation is trying to obtain control of the Academy and should not be allowed to vote shares of the Academy in its quest for control. This allows directors to act without checks and balances upon their power. This same reason was present for the court in *Italo Petroleum Corp. of America v. Producers' Oil Corp.*, 174 A. 276, 278-79 (Del. Chan. 1934). The court was deciding the question as to whether a wholly-owned subsidiary is permitted to vote its stockholdings in a parent company. The court answered the question in the negative and construed the statutory prohibition against voting stock belonging to the corporation as a prohibition against voting stock belonging directly or indirectly to the corporation. In their holding the court was motivated by the same concerns as pre-statutory cases: "It seems to me to be carrying the doctrine of distinct corporate entity to an unreasonable extreme to say that, in a contest over control of a corporation those in charge of it should be allowed to have votes count in their favor which are cast by a subsidiary stockholder wholly owned, controlled, dominated and therefore dictated to by themselves as the spokesman of the parent." *Italo*, 174 A. at 279. For the same reasons, the directors of the Foundation and the Academy should not be allowed to vote shares of the Academy to ratify past acts by its directors.

Defendants do not even discuss the issue of waste as argued in the Appellant's Brief on pages 13-16. It is important to again note that corporate waste of assets is considered a void act that cannot be ratified. The transfer of the schools business was a gift that lacked consideration and was taken without consideration of the duties owed by the directors to the shareholders.

Defendants also allege on page 8 of Appellee's Brief that Plaintiffs have never defined or offered case law as to define a special purpose corporation. Defendants are correct that the case law cited by Plaintiffs did not include a definition of a special purpose corporation; however, the *Tallahatchie Valley Electric Power Association* case and the *Blue Cross and Blue Shield v. Protective Life Ins. Co.* case provided authority to show that corporations formed for specific purposes have no powers other than those necessary to effect the corporate purposes for which they were organized. Miss. Code Ann. § 79-4-3.01provides that "Every corporation incorporated under Sections 79-4-1.01 et seq. has the purpose of engaging in any lawful business unless a more limited purpose is set forth in the articles of incorporation." In the Academy's articles of incorporation as previously stated, the incorporator limited the corporations purpose by including the language that "The specific purpose or purposes for which the corporation is organized in general terms are (1) To organize, own and operate primary schools, secondary schools and/or colleges and other educational institutions for the education of youth...". (R.E. 301). It is the Plaintiff's position that by relegating the Academy to a real estate holding company, that the directors of the Academy and the Foundation altered the purpose for which it was created.

The Defendants argue that the following language contained with the corporate charter grants the directors the power to do the things complained of by Plaintiffs:

(5) To have and to exercise all powers conferred by the laws of the

> State of Mississippi upon corporations. (6) To purchase, own, lease, hire, or otherwise acquire real and personal property, improved and unimproved, of every kind and description, and to sell, dispose of, lease, convey, encumber and mortgage said property, or any part thereof. To acquire, hold, lease, manage, operate develop, control, build, erect, maintain for the purposes of said corporation, construct, reconstruct or purchase, either directly or through ownership of stock in any corporation, any lands, buildings, offices, stores, warehouses, plants, machinery, rights, easements, privileges, franchises and licenses, and to sell, lease, hire or otherwise dispose of lands, buildings or other property of the corporation, or any part thereof. (7) To do all and everything necessary and proper for the accomplishment of the objects herein enumerated or necessary or incidental to the benefit of the corporation.

(R.E. 301). The Plaintiffs would agree that the corporation has all those powers in the charter to operate schools for purposes beneficial and incidental to the corporation and above all to its shareholders. However, corporate law must be complied with and the directors have a duty to the shareholders. The Defendants do not have the power to alter the fundamental purpose of the corporation from operating schools to relegating it to a real estate holding company. The above stated language, in Sections (5) and (6) "to have all powers conferred by the laws of the State of Mississippi" and to "own, lease, hire or otherwise acquire real and personal property" is boiler plate language inserted into all articles of incorporation to allow corporations the power to carry on their business, and for certain protection from lawsuits, and to do business in the state. However, the directors were not conferred power to give away its corporate assets without any consideration. The directors were not conferred power by the above stated language to completely ignore corporate formalities. The directors were not conferred power to take the actions it took without regard to the shareholders.

This case is about fundamental corporate democracy and law. The Defendants have a

pattern of failing to follow corporate formalities. The Defendants position is that we can operate in a state of dissolution for years. We can ignore corporate formalities regarding minutes and resolutions. We can take actions against the shareholders interests. It does not matter. We are the directors. We can do all of this and just correct it with a ratification vote five years later. While there is no Mississippi law on this complex issue, the Plaintiffs assert that the law on ratification should not be allowed to extend back this far to correct such a complete lack of respect for the formalities of corporate governance.

Mr. Keene has three nephews in the school and several grandchildren who will be attending the school in the future. This lawsuit is about the fact that there is always a right way and a wrong way to do things. Mr. Keene wants these children to attend a school that both he and they would be proud to call their home school.

CONCLUSION

The Plaintiffs request this Honorable Court to reverse the Chancery Court of Lincoln County, Mississippi on all issues.

RESPECTFULLY SUBMITTED,

BY: _____

DURWOOD E. MCGUFFEE, JR.,
Attorney for Appellants

CERTIFICATE OF SERVICE

I, Durwood E. McGuffee, Jr., attorney for Appellant, do hereby certify that I have this day filed this Reply Brief of Appellant with the Clerk of this Court to be received on behalf of the Mississippi Supreme Court and have mailed a true and correct copy of the Reply Brief to the following:

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CERTIFIED, This the 10th day of August, 2009.

DURWOOD E. MCGUFFEE, JR.