

**IN THE COURT OF APPEALS 12/12/95**

**OF THE**

**STATE OF MISSISSIPPI**

**NO. 94-CA-00150 COA**

**THE STREET CLINIC, A PROFESSIONAL ASSOCIATION**

**APPELLANT**

**v.**

**GENE T. WALKER AND GERALD M. RANKIN**

**APPELLEES**

THIS OPINION IS NOT DESIGNATED FOR PUBLICATION AND  
MAY NOT BE CITED, PURSUANT TO M.R.A.P. 35-B

TRIAL JUDGE: HON. NATHAN P. ADAMS, JR.

COURT FROM WHICH APPEALED: WARREN COUNTY CHANCERY COURT

ATTORNEY FOR APPELLANT:

WILLIAM M. BOST, JR.

ATTORNEY FOR APPELLEES:

KELLIS MADISON

NATURE OF THE CASE: CONTRACT INTERPRETATION

TRIAL COURT DISPOSITION: RULED IN FAVOR OF DEFENDANT/APPELLEES

BEFORE FRAISER, C.J., COLEMAN, AND SOUTHWICK, JJ.

COLEMAN, J., FOR THE COURT:

This case originated in the Warren County Chancery Court when The Street Clinic (Clinic), a

professional corporation, filed a Complaint against Gene T. Walker, M. D. (Dr. Walker), and Gerald M. Rankin, M. D. (Dr. Rankin), to compel each of them to surrender his one share of stock in the Clinic in compliance with a stock agreement (Stock Agreement). The Clinic and the physician shareholders had executed this Stock Agreement when the Clinic incorporated on December 22, 1989. The Stock Agreement was a stock redemption agreement which specified a formula for evaluating shares at buy-back time. The fulcrum upon which the Agreement -- and thus this litigation -- pivoted was the definition of the term "intangible assets" as contained in the Stock Agreement. The Clinic interpreted the term "intangible assets" to require that Drs. Walker's and Rankin's shares were of no value when these two physicians decided to leave the Clinic's employment. The doctors responded that because of a recent settlement with the Sisters of Mercy in Vicksburg, by which that Order placed \$2,628,814 in escrow for the construction of a new office building for the Clinic, each share of stock in the Clinic was worth \$150,561. The chancellor accepted Drs. Walker and Rankin's interpretation of the Stock Agreement and ordered the Clinic to increase the value of each share of its stock from zero Dollars to \$150,561. The Clinic has appealed the chancellor's order to increase the value of each share of stock to \$150,561. It asserts three issues on which it predicates the error of the chancellor's decision. We affirm the chancellor's adjudication of the issues in this case.

## **I. Facts**

### **A. History of the Street Clinic**

Dr. D. P. Street founded The Street Clinic in 1900. The Clinic functioned as a partnership until 1955, when it was reorganized as an unincorporated professional association governed by a Board of Directors. The association's members elected the members of the Board of Directors. On December 22, 1989, the Clinic was incorporated for the group practice of medicine. Physicians who had been members of the unincorporated professional association simply exchanged their interest in the unincorporated professional association for one share of stock in the newly created professional association.

The Clinic's Articles of Incorporation restricts the issue of shares of its stock to persons who are duly licensed to practice medicine or related professional fields as were the persons who incorporated the Clinic. The charter further provides that no shareholders may sell or transfer his or her share in the corporation except as provided in the corporation's bylaws. Article VI, Section 2 of the bylaws provides that no stock shall be issued to any physician who does not execute the Stock Agreement between the corporation and its shareholders for the ownership of stock in the clinic. Pursuant to Article VI, Section 2 of the bylaws any physician whose employment with the corporation terminates shall sell his or her stock to the corporation under the terms and provisions of the Stock Agreement. The bylaws were executed by all the physicians who were practicing with the Clinic as of its date of incorporation, December 22, 1989. Among this group of physicians were the appellees, Drs. Walker and Rankin.

Simultaneously with their adoption of the corporate bylaws, all the shareholders of the Clinic on the one hand and the Clinic as a professional corporation on the other hand executed the Stock Agreement. The Stock Agreement established a formula for calculating the value of a share of stock in the Clinic when a member of the Clinic terminated his or her employment/membership in the Clinic and, pursuant to the Stock Agreement, transferred his or her one share of stock to the Clinic. Article

III, Paragraph (1) of the Stock Agreement contains this formula. It reads as follows:

The purchase price for each share of stock of the corporation, which is sold pursuant to the provisions of this agreement, shall be the book value per share of the stock, which shall be computed based on the financial statements of the corporation on December 31 immediately preceding the date of the shareholder's termination of employment, which book value shall not include any accounts receivable, goodwill, or *other intangible asset*. (emphasis added).

As we earlier indicated, the dispute which is the subject of this appeal arose from the conflict in the Clinic's and Drs. Walker and Rankin's respective interpretations of the phrase "other intangible asset."

The dispute began when the appellees, Drs. Walker and Rankin, resigned from the Clinic on June 7, 1991. Because they disputed the negative equity of their shares of stock which the December 31, 1990, financial statement indicated, Drs. Walker and Rankin refused to deliver their shares of stock to the Clinic in accordance with its bylaws and the Stock Agreement. We have already noted that as of Drs. Walker and Rankin's resignation the Clinic valued each physician's share of stock as zero Dollars, but Drs. Walker and Rankin each valued his share of stock at \$150,561.

#### **B. Relationship of the Street Clinic to the Sisters of Mercy Hospital**

The dispute between the Clinic and Drs. Walker and Rankin ensued from the relationship of the Street Clinic to the Sisters of Mercy (Sisters) and the Mercy Regional Medical Center (Hospital), the hospital which that Order operated in Vicksburg. The Clinic was located in quarters furnished by the Hospital. The Clinic had been at this location since the mid-1950's. The Sisters had promised the Clinic rent free space as soon as they had paid their debt on the hospital building. The Street Clinic owned or operated x-ray, laboratory, nuclear medicine, EEG, and other hospital based services before October, 1982.

On September 30, 1982, the Clinic and the Sisters of Mercy entered into three agreements which provided for the transfer of hospital-based services owned by the Clinic to the Hospital. (We shall refer to these agreements as the "1982 Agreements" to distinguish them from the Stock Agreement among the Clinic and physicians which is the subject of this litigation.) These three agreements were (1) the Master Agreement, (2) the Building Agreement, and (3) the Department Agreements. The Master Agreement contained a stipulated damages clause that obligated the Hospital, upon its breach of these 1982 Agreements, to pay the Clinic an amount of money in excess of Two Hundred Million Dollars (\$200,000,000). The Building Agreement was a long-term lease that provided the Clinic with rent-free space in a medical office building which the Sisters of Mercy owned. The Department Agreements consisted of separate agreements concerning each of the departments in the Hospital for which the Clinic was to provide services in return for which the Clinic received monthly income from the Hospital. This monthly income which the Hospital payed the Clinic represented a share of the fees from patients of the Hospital's services, many of whom the Clinic referred to the Hospital.

#### **C. Dispute and Litigation Between the Street Clinic and the Sisters of**

## Mercy

However, as time passed, evolving federal law jeopardized these agreements. The Sisters wanted to terminate the agreements and to sell their Hospital. The sale of the Hospital was subject to the Clinic's veto. In March, 1990, the Sisters sued the Clinic. On May 7, 1990, the Sisters of Mercy endeavored unilaterally to terminate all the 1982 Agreements, one of which provided the Clinic with space in a building owned by the Sisters of Mercy. For this office space the Clinic paid the Sisters rent of \$1.00 per year. This building was located adjacent to their hospital. Regardless of their attempt to terminate the 1982 Agreements unilaterally, the Sisters of Mercy continued to pay the Clinic pursuant to those Agreements until November 1, 1990. The Clinic's near rent-free use of the Sister's office building continued until May 1, 1991.

On May 15, 1990, the shareholder physicians of the Clinic voted to accept the Sister's offer of settlement of \$3,000,000; and they wrote the Sisters to inform them that the Clinic would accept \$3,000,000 in cash to settle the lawsuits. Sometime later, the Clinic began to negotiate with the Sisters to settle their litigation over the 1982 Agreements through a "like kind" exchange between the Clinic and the Sisters of Mercy, rather than the Sisters' payment of \$3,000,000 in cash to the Clinic.

On September 19, 1990, Dr. Daniel Dare, a physician of the Clinic, moved at a meeting of the Clinic's shareholders to accept the Sisters' settlement of \$3,000,000 and then to divide the proceeds of that settlement among the Clinic's shareholders. By a vote of 10 to 7, the Clinic's physician-shareholders defeated Dr. Dare's motion. Drs. Walker and Rankin voted in favor of the motion to accept the settlement of \$3,000,000. On September 20, 1990, the Sisters of Mercy tentatively agreed to settle the pending litigation by way of a \$3,000,000 tax-free exchange of property. Under the terms of this tax-free exchange, the Clinic would exchange the Building Agreement, the old asset, for a new medical office building and some land, the new asset. This new asset, the medical office building, would have the same cost basis as the old asset, the Building Agreement. The cost basis of the Building Agreement was zero Dollars; thus the cost basis of the new medical office building would also be zero. By following this route to settlement, the \$3,000,000 proceeds from the settlement with the Sisters of Mercy would not increase the book value of the stock in the Clinic.

On November 1, 1990, the Sisters sold the Mercy Regional Medical Center to Quorum, which renamed the hospital "Parkview." Since there was no building yet ready into which the Clinic might move, a majority of the Clinic's physicians voted to settle the dispute with the previously described tax-free exchange, by which the Sisters of Mercy would transfer a parcel of land and \$2,628,814 to an escrow agent. The initial amount of the settlement, \$3,000,000, was reduced by \$255,000 to accommodate the Clinic in complying with the IRS rules on a like-kind exchange. In accordance with the settlement agreement, the 1982 lease, by the terms of which the Clinic rented the Sisters' building for \$1.00 per year, remained in place until May 1, 1991. The sum of \$2,628,814, the deed to the lot on which the office building was to be built, and the conveyance of the 1982 Building Agreement to the Clinic was placed in escrow, for which First National Bank of Vicksburg served as the escrow agent. The Clinic and the Sisters anticipated that the new medical office building would be ready for the Clinic's occupancy by October 31, 1991. In fact, the Clinic occupied the new medical office building in late October, 1991. None of the settlement proceeds which the Sisters paid the Clinic

were recorded on the Clinic's financial statement for 1990.

#### **D. Relationship of the Street Clinic to its Physicians**

Throughout its existence, whether incorporated or not, the Clinic was the entity through which its associated physicians earned money. The physicians were paid proportionately to their production, the consideration for which was their conveying to the Clinic their accounts receivable. The Clinic alleges that none of its member physicians had ever been compensated for his or her interest in the association when he or she left the Clinic before its incorporation on December 22, 1989. The Clinic's physicians had agreed that in the event of the dissolution of the association which preceded the incorporation of the Clinic, the Street Medical Foundation would receive and own the Clinic's assets. However, prior to the Clinic's incorporation, its member physicians amended the bylaws to provide that the members of the association would receive the Clinic's assets were the unincorporated professional association ever to be dissolved. The Clinic asserts that with its incorporation, the effect of dissolution changed, but its members still clung to the old concept of "you came with nothing, you leave with nothing."

The Clinic further contends that this philosophy was incorporated into the previously quoted formula drafted by James Dossett, a tax attorney, when the Clinic's corporate structure was designed. The Clinic insists that by their execution of the various documents of the Clinic's incorporation on December 22, 1989, the physicians who were members of the prior unincorporated professional association but who were to become shareholders in the newly incorporated Clinic, purposefully excluded certain assets of very substantial worth, *i. e.*, accounts receivable and the 1982 Agreements.

Because of an alleged dispute with the Clinic about Medicare and Medicaid patients, Drs. Walker and Rankin decided to leave the Clinic after the previously described settlement with the Sisters had been completed. In June, they gave notice of their resignation from the Clinic as of June 21, 1991. They advised the other shareholders in the Clinic that they wanted \$200,000 for each share of stock in the Clinic. The other shareholders in the Clinic refused Drs. Walker and Rankin's demand because they were of the opinion that according to the definition of share value contained in the Stock Agreement each share had a negative value. Drs. Walker and Rankin refused to relinquish possession to the Clinic of their shares of stock in it.

#### **II. Litigation**

On September 30, 1991, The Street Clinic filed its Complaint for Specific Performance or in the Alternative, a Mandatory Injunction against Drs. Gene T. Walker and Gerald M. Rankin in which the Clinic asked the Warren County Chancery Court to "enter its order directing specific performance of the Stock Agreement . . . or grant its mandatory injunction directing that the Defendants transfer all of their shares of stock in the [Clinic] in accordance with the Stock Agreement and that reasonable attorney fees be assessed in the premises." On November 27, 1991, Drs. Walker and Rankin filed their Answer of Defendants to Complaint, in which they incorporated a counterclaim. The two physicians counterclaimed for the court's "judgment declaring all rights of the parties under the Stock Agreement" and for both actual and punitive damages (including attorney's fees.)

Following discovery by the parties, the chancellor tried this case on November 15 and 16, 1993. Because of the standard of review applicable to matters of this sort, to which this Court subsequently

alludes, a recounting and an analysis of the testimony and evidence in the record of this trial seems appropriate.

William Briggs Hopson, Jr., M. D., a surgeon who served as Chairman of the Board of Directors of The Street Clinic since its incorporation as professional corporation in December, 1989, testified under cross examination that the "whole basis of this thing [was] to look at this thing from a tax-free standpoint to get the building." Dr. Hopson assumed that "money is an asset." He acknowledged that the Stock Agreement gave any shareholder "a right to go to court if he or she had a dispute over the stock." Dr. Hopson acknowledged that when the Clinic's shareholders signed the Stock Agreement and stock in the Clinic was issued, the prior theme of the Clinic, "You came with nothing; you leave with nothing," had no more meaning. The theme had no more meaning "[B]ecause there could have been some assets or some values of stock [in the Clinic]."

The Clinic's next witness was Steve Sessums, a certified public accountant, who practiced with May & Company, an accounting firm in Vicksburg. Sessums had been responsible for the Clinic's audits since 1984. Sessums testified on direct examination that the Clinic's financial statements had been prepared on a cash basis, which was a generally accepted accounting principle. He advised the Court that cash basis is an "other comprehensive basis of accounting," or "OCBOA." He contrasted OCBOA with "Generally accepted accounting principles," or "GAAP," by stating that GAAP attempted to measure revenue when it's earned and expenses when they are incurred. On the other hand, as its name would imply, "[A] modified cash basis statement would recognize revenue when cash is received and recognize expenses when they are . . . paid."

Sessums then testified that the Clinic directed him to use a cash basis for preparing the 1990 Financial Statement and that since 1984 he had prepared all annual financial statements for the Clinic on a cash basis. Sessums established that on a modified cash basis, the Clinic's Financial Statement for 1990 reflected that the shareholders' equity was a negative \$85,485.00. Nineteen shares of stock in the Clinic were outstanding at the close of 1990. He explained that the 1990 Financial Statement was not on a pure cash basis because there were some modifications, such as equipment and improvements, which were capitalized and then depreciated. Another exception to the pure cash basis which Sessums noted was that the payroll taxes were shown as a liability even though they would be paid in a subsequent period.

Sessums then testified that the existing Building Agreements had no cost basis on the annual financial statements for the Clinic. He explained that in 1982 the Clinic exchanged with the Hospital its internally generated departments, *i. e.*, x-ray and laboratory, among others, for the previously described Building Agreement and for certain Department Agreements, which have also been previously described in this opinion. The Hospital also executed a promissory note in an amount of either \$500,000 or \$700,000, which, when the Hospital paid it, was recognized as income. The Clinic's annual financial statements never reflected the Hospital's promissory note as an asset before the Hospital paid it. The income from the Department Agreements was recognized in the year the cash from these agreements was received.

On cross-examination, Sessums admitted that after the Clinic had been incorporated, its shareholders owned interests in the assets to which the Clinic as a professional corporation held title. Sessums acknowledged that the 1982 Agreements were indeed assets of the professional corporation even

though they were never recorded in the Clinic's annual Financial Statements. As had Dr. Hopson, Sessums admitted that the former policy of "You came with nothing; you leave with nothing," was changed by the incorporation of The Street Clinic on December 22, 1989. He further conceded that the Stock Agreement contained no definition of the word "intangible" as it was utilized in the phrase, "intangible asset" in the Stock Agreement. He noted that the Stock Agreement did not specify what method of accounting -- OCBOA or GAAP -- was to be used in calculating the book value of the stock at the end of each calendar year.

When he was asked about the use of the word "tax-free" to describe the settlement transaction between the Hospital and the Clinic, Sessums answered:

It's tax free -- under Code Section 1031. When you exchange property, the basis in the acquired property is your basis in the property that you have given up. So if you subsequently sell the acquired property, then you do have taxes. If you hold the property, you do not have taxes. So it's -- it's potentially deferred, but it could be tax-free if you hold the property indefinitely.

Sessums agreed that cash was a "tangible asset." Sessums was asked this question:

The Settlement Agreement included more than a like kind exchange of property, didn't it?

To this question, he answered, "Yes." Sessums recognized that he had used a GAAP rule to list the Settlement Agreement in the Clinic's 1990 Financial Statement even though he had prepared it on a modified cash basis; but he further opined that the treatment of the Settlement Agreement would have been the same under either OCBOA or GAAP.

Sessums acknowledged that the tax treatment of this Settlement Agreement was not dependent on its accounting treatment. Thus, it followed that the settlement's treatment as a tax-deferred exchange under tax law would not affect its accounting treatment. Sessums repeated that management controlled the content of the financial statement -- and not the accountant who prepared it. As an example of the Clinic's control over the contents of its financial statement, Sessums told the Court that its board of directors decided to pay \$286,046 worth of bills in 1991 which had become due in 1990 because the Clinic did not have the cash to pay them in 1990. The effect of this decision was to decrease the value of the shareholders' equity in 1991 by that same amount. To be consistent with a modified cash basis, the Clinic ought to have paid these bills in 1990.

Sessums' cross-examination concluded with the admission that in his deposition taken before trial, he conceded that handling the Settlement Agreement as a tax-free transaction in 1990 "was probably not in the best interest" of a shareholder who was leaving the Clinic in 1991 -- as did Drs. Walker and Rankin.

James K. "Jim" Dossett, Jr., a tax attorney from Jackson, testified that his firm first served The Street Clinic in the early 1980's and that his firm had assisted the Clinic to incorporate in 1989. He testified that were the Clinic to be dissolved as a professional corporation, its assets would become the property of its shareholders. He opined that cash would be included in the computation of the "book value" of the stock in the Clinic. He too agreed that the method of accounting was a management decision and that there was nothing in the Stock Agreement that prevented the Clinic's annual

financial statements from being prepared on a different accounting basis each succeeding year.

William Dossett, a tax attorney who was the brother of James K. "Jim" Dossett, Jr., in response to the chancellor's question, opined that the shareholders in the Clinic did not own any beneficial interest in the funds which had been placed into escrow with the First National Bank of Vicksburg. On cross-examination, William Dossett stated that a like kind exchange deferred the payment of income tax as opposed to avoiding payment entirely. He further acknowledged that the like kind exchange was done primarily for the benefit of the Street Clinic.

Hugh James Parker, Ph. D., C. P. A., and Dean of the Else School of Management at Millsaps College, was the Clinic's final witness. Dr. Parker supported Steve Sessums' expertise. He agreed with Sessums that while the accountant may help management with the contents of the financial statement, only management decides "what leads to those numbers" in the financial statement. He opined that OCBOA accounting principles do not require the listing of assets on company financial statements, at least "until the cash flows" from the asset. Management can decide to use some GAAP rules and exclude others. Dr. Parker testified that management can decide which GAAP rules to use based on the reasonableness of the decision and its responsibilities to its owners and creditors.

Dr. Parker testified on cross-examination that "Clearly, [the \$2.6 million Dollars placed in escrow] was an asset that existed. He admitted that it was possible for management to exclude assets and liabilities from the financial statements under the modified cash basis of accounting. He further conceded that GAAP rules were silent about the appropriate treatment of assets placed in escrow.

Wallace Collins, C. P. A., was Drs. Walker and Rankin's first witness. What follow are quoted portions of his testimony:

Q. Based on your experience as a Certified Public Accountant and upon your review of the documents that you mentioned, do you have an opinion as to whether or not the 1990 settlement transaction between The Street Clinic and the Sisters of Mercy was properly recorded on the 1990 Street Clinic financial statements as prepared by May & Company?

A. I do have an opinion.

Q. And what is that opinion?

A. My opinion is that the transaction was not properly recorded; that there should have been value recorded on the 1990 financial statement for the settlement of the lawsuit with the -- with Mercy.

Q. Why do you think that amount should have been recorded?

A. Well, the facts in the situation are as follows: There was a settlement of the lawsuits with Mercy, and it occurred on November the 1st, 1990. There was cash that changed hands on that date, some \$2.6 million Dollars. The Clinic had the option of receiving cash but decided to structure the transaction to attempt to comply with the tax laws and make the transaction nontaxable. The Clinic also received real estate valued at \$140,000, and those transactions all

were basically completed on November the 1st of 1990. And the summary of that scenario is that the Clinic constructively received the cash on November the 1st of 1990. That's the substance of the transaction.

Collins noted that the Clinic received interest on the money deposited into the escrow account beginning with the date of deposit, November 1, 1990, through May 1, 1991, in the amount of at least \$50,000, all of which interest the Clinic included in its financial statements and income tax returns for 1990 and 1991. He testified that the Clinic's treatment of this interest in this fashion further supported his opinion that the sums and property realized from the settlement with the Hospital ought to have been included in the Clinic's financial statement for 1990. When Collins was asked on direct examination whether, in his opinion, the 1990 settlement transaction between the Street Clinic and the Sisters of Mercy was a nonmonetary transaction, he replied:

It's my opinion that the transaction is not a nonmonetary transaction. And my authority for that is by definition a nonmonetary transaction is a transaction that involves little or no cash. This transaction involved \$2.6 million in cash. Accordingly, it should be treated as a monetary transaction.

Collins was of the opinion that the redemption price of each share should be based on eighteen shareholders outstanding and that the redemption price should be \$150,561.00 per share. He calculated this redemption price based on the Clinic's Financial Statement for 1990 as prepared by May & Company, in which May & Company had calculated a deficit stockholders' equity of \$85,000. To this deficit he added the \$2,648,814 deposited into the escrow account, the interest earned on the money deposited into escrow through December 31, 1990, in the amount of \$26,766, and the lot received in escrow, the value of which was \$140,000. The sum of the three escrow items was \$2,795,580. The subtraction of the deficit of \$85,485 in shareholder's equity from this sum of \$2,795,580 left a balance of \$2,710,095. This balance of \$2,710,095 divided by 18, the number of outstanding shares of stock in the Clinic, resulted in the book value of \$150,561.00 per share.

On cross-examination, Collins opined that when the substance of the transaction differed from the form, the auditor was required to apply the substance. Thus, while the Clinic did not report the interest which had accrued on the funds in escrow in 1990 until the tax year 1991, Collins was of the opinion that the Clinic should have reported the interest in the 1990 tax year. Collins termed the Clinic's reporting of this interest as income in 1991 even though it had been earned in 1990 as "clever." Collins applied "substance over form" to the proceeds of the settlement with the Hospital to determine that the sum of those proceeds, \$2,648,814, would be income to the Clinic in the year 1990. As to whether this income was taxable to the Clinic, Collins had formed no opinion. He did testify that "[I]t's also possible that this transaction qualifies as a tax deferred exchange." He thought that "There are some serious problems with it, but I think -- it may or may not." Collins concluded that whether the transaction were taxable had no bearing on his opinion that the settlement proceeds should have been included in the Clinic's 1990 Financial Statement. He observed that the Clinic had differences between its books and its tax returns. He stated, "That's obvious from looking at them."

Collins told the chancellor:

Code Section 1031 [of the Internal Revenue Code] doesn't deal with substance. It deals with the form of the transaction. If you comply with a form, then you shouldn't have a

taxable transaction for tax purposes. . . . These documents were drawn up to attempt to comply with the tax laws, and they've been tortured seriously to even meet the minimum requirements.

Cecil Wayne Harper, also a certified public accountant, was Drs. Walker and Rankin's next expert witness. Harper was of the opinion that

[Y]ou've got two separate transactions. You've got the settlement of a lawsuit of \$3 million dollars, and you've got the use of the proceeds to build a new building. And in my opinion, the \$3 million dollars should have been reflected on the balance sheet of The Street Clinic and Drs. Walker and Rankin have their pro rata share at that time.

Harper agreed with Collins that the settlement proceeds did not qualify as a nonmonetary exchange. He also opined that the accounting issues and the tax issues were two different things.

After all of the parties had rested, the chancellor requested them to submit findings of fact and conclusions of law -- "the same kind of document that is submitted in the Federal District Court to the Magistrate." After the parties' had filed their request for findings of fact and conclusions of law, the chancellor made his Ruling of the Court on December 9, 1993. The chancellor incorporated his findings of fact and conclusions of law in his Ruling of the Court. Many of his findings of fact were included in the "**Facts**" portion of this opinion, but because this court finds the following facts and conclusions of law to be especially relevant to its resolution of the issues in this appeal, it quotes them as follows:

#### **A. Findings of fact:**

The Stock Agreement does not contain any references to lawsuit settlement proceeds, escrow agreements or accounts, non-monetary exchanges, method of accounting or tax-free exchanges (testimony of Steve Sessums and James Dossett).

Before the incorporation [of The Street Clinic], no associate or member had ever been compensated for his or her interest at termination of membership (Hopson testimony).

Audited annual financial statements have for many years been prepared by May and Company on a modified cash basis which is an Other Comprehensive Basis of Accounting or OCBOA, a common practice among professional groups. (Exhibit 5, Sessums). The audit statements were not prepared according to Generally Accepted Accounting Principles (GAAP) which is also a common practice among professional groups (Sessums, Parker).

Sometime after May 15, 1990, The Street Clinic's lawyers began negotiations with the Mercy parties for a like kind exchange to be formulated in lieu of accepting cash. This plan would allow the Street Clinic to defer the payment of taxes on the settlement amount.

The Clinic physicians were advised that assets with no cash basis were being exchanged for the new asset which would likewise have no cost basis (Exhibit 21). To do other than the like-kind exchange would have resulted in the Clinic's paying substantial income taxes, perhaps \$1,000,000 (Exhibit 21, Sessums, W. Dossett). The like-kind exchange was

structured to exchange the Building Agreement of 1982 for a new building (J. Dossett, Exhibit 26). The escrow exchange served legitimate business purposes and was not done entirely to satisfy Internal Revenue regulations (No reference to the record).

It is undisputed that the [1982] Department Agreements (Exhibit 2) were probably unenforceable and valueless because of changes in federal laws (Hopson). Pursuant to the Settlement Agreement (Exhibit 25, paragraph 14, page 9) executed November 1, 1990, the Street Clinic parties and the Mercy parties agreed the Settlement Agreement was made solely in compromise and settlement of disputed claims (No reference to the record).

Drs. Rankin and Walker did not sign or otherwise execute any of the settlement agreements including the Indemnification Agreement (Exhibit 28). Drs. Rankin and Walker, as shareholders, never voted in favor of the like-kind transaction, but did vote to accept cash (No reference to the record).

On or before November 1, 1990, the Mercy parties paid into escrow \$2,628,814.00 in cash and deposited the deed to a tract of land valued at \$140,000 (stipulation 20), plus certain other expenses for the construction of a new medical office building on the land (Exhibit 25, paragraph 1.1). These amounts were adequate to execute the Settlement Agreement (paragraph 1.2) regardless of the outcome of the like-kind exchange. The like-kind exchange transaction was for the benefit of the Street Clinic (testimony of William Dossett).

*According to the expert testimony of Wallace Collins, CPA, and Cecil Harper, CPA, The Street Clinic constructively received from Mercy the following assets in 1990; \$2,628,814.00 in cash, \$140,000 worth of land, and earned interest of \$26,766 on the \$2,628,814.00 placed in escrow. According to their testimony, these assets are tangible assets and should have been recorded on the 1990 Street Clinic financial statements. The Street Clinic was the beneficiary of all assets that went into escrow. All documents relating to the like-kind exchange were for the benefit of the Street Clinic (Exhibits 13, 17, 21, 53, 59, 61, 62, 63 and 25). Based upon the expert opinion testimony of Wallace Collins and Cecil Harper, the book value per share of Street Clinic stock for the year ending 1990 would be not less than \$150,561 (Exhibit 10). (Emphasis added.)*

Effective December 17, 1990, The Street Clinic Board adopted a policy of assessing fees and costs to any shareholders who litigate any adverse position with the Clinic (Exhibit 34). The "adverse position resolution" was passed to prohibit shareholders from suing the Street Clinic at a time when the Board of Directors knew or reasonably should have known that Drs. Rankin and Walker were leaving the Clinic (testimony of Dr. Hopson, Exhibits 30, 31, 32, 33, and 34). The resolution was never agreed to by either Dr. Rankin or Dr. Walker and is not in the best interest of all shareholders.

## **B. Conclusions of law**

The adverse position resolution contravenes Article VIII of the Stock Agreement and is

unenforceable (Exhibits 34 and 10).

All negotiations between the Sisters of Mercy and The Street Clinic are merged into the settlement agreement. In the absence of any agreement to the contrary, an instrument or deed held in escrow by a third party (bank) does not take effect until its final or second delivery. However, Mississippi recognizes the rule "whenever justice or necessity demands resort to fiction to ward off intervening claims or liens, a court of equity will give a relation back and cause it to take effect from its first delivery as an escrow." The Court has very carefully examined Exhibit 27, Escrow Agreement. Medical Center deposited \$2,628,814.00 and an executed deed. Street Clinic deposited a conveyance instrument conveying its interest in the Building Agreement and a parking easement. Escrow Agent was to thereafter enter into contracts for the construction on a new building for Street Clinic to be completed by May 1, 1991 or October 25, 1991, if not completed by the earlier date. The construction was for the benefit of Street Clinic. In the event construction was not complete, Escrow Agent was to assign construction contracts to Street for completion. Any excess costs over and above escrowee sums were the obligation of Street. Street Clinic had the right to approve almost every act of the Escrow Agent, including construction. Nothing of consequence remained for Street Clinic to do except await the final completion of the building. As a result, the Court concludes that Street Clinic had at the very minimum on November 1, 1990, an equitable interest in the assets deposited by Mercy Center into the escrow agreement with minimal actions required of Street to complete the escrow. (Citations omitted.)

The Court concludes that The Street Clinic, a professional corporation, acquired an equitable interest in cash of \$2,628,814.00 and land worth \$140,000 on November 1, 1990, in exchange for assignment of Street's interest in the Building Agreement and the grant of an easement for parking purposes. The equitable interest amounted to ownership of the cash and land, tangible assets, and should have been recorded on the books of the corporation to indicate shareholder ownership. The court recognizes the right of the corporation to report the transaction for tax purposes in a manner consistent with accounting principles. (Citations omitted.)

Purchase price is an absolute requisite for the remedy of specific performance. The Street Clinic is not entitled to specific performance because the purchase price it is offering Drs. Rankin and Walker for their stock (zero dollars) is not the purchase price specified in the Stock Agreement. Under Article III of the Stock Agreement, tangible assets are to be included in the computation of book value. The proceeds from the 1990 settlement between the Street Clinic and Mercy included \$2.6 million in cash and \$140,000 worth of land, all of which are tangible assets. In consequence, the consideration which the Street Clinic is obligated to pay Drs. Rankin and Walker for their shares of stock under the terms of the Stock Agreement should include the proceeds from the 1990 settlement between Mercy and the Street Clinic.

Stockholders in a close corporation must bear toward each other the same relationship of trust and confidence which prevails in partnerships. Dealings among stockholders in a close corporation must be "intrinsically fair." Moreover, corporate officers and directors

owe shareholders the duty to exercise utmost good faith and loyalty in discharge of the corporate office. Corporate officers are wholly subject to this duty when they deal with corporate property. *Fought v. Morris*, 543 So. 2d 167 (Miss. 1989)] requires that the treatment of the proceeds from the 1990 settlement between Mercy and the Street Clinic be "intrinsically fair" to all shareholders, including withdrawing shareholders such as Drs. Rankin and Walker. Excluding the proceeds of the 1990 settlement between Mercy and the Street Clinic from the 1990 financial statement of the Street Clinic was simply not "intrinsically fair" within the meaning of *Fought*, nor was it in accordance with Article III of the Stock Agreement. The duty of corporate directors to exercise utmost good faith and loyalty when they deal with corporate property was breached when the directors of the Street Clinic failed to have any of the settlement proceeds received for surrendering the 1982 Agreements recorded on the 1990 financial statement of the Street Clinic.

In accordance with the foregoing findings of fact and conclusions of law, the chancellor rendered a Final Judgment on the 19th day of January, 1994, in which he ordered and adjudged the following:

- (a) The adverse position resolution contravenes Article VII of the Stock Agreement and is unenforceable.
- (b) Plaintiff's [The Street Clinic's] suit for specific performance is hereby dismissed.
- (c) The financial statements of The Street Clinic should be amended so as to show the receipt of \$2,628,814 in cash, \$140,000 worth of land, and earned interest of \$26,766 during the calendar year 1990.
- (d) The book value per share of stock for the year ending 1990 is not less than the sum of \$150,561 per share of corporate stock.
- (e) This judgment is without prejudice to the right of The Street Clinic to report the "Mercy" transaction as a like-kind exchange for income tax purposes.
- (f) Defendants' claims for either actual or punitive damages against The Street Clinic are denied.
- (g) Costs are assessed to the Plaintiff.

This judgment was entered on January 20, 1994, and the Plaintiff, The Street Clinic, filed its Notice of Appeal on February 9, 1994.

### **III. Discussion of the Issues**

Appellant, The Street Clinic, presents three issues for this Court's analysis and determination. We repeat the Clinic's issues as it wrote them in its brief:

1. The Chancery Court erred by not requiring Defendants to deliver their shares of stock to Plaintiff pursuant to the formula established in the Stock Agreement.
2. The Chancery Court erred by directing the Plaintiff to increase the Defendants' Stock values to \$150,561 by directing the inclusion of assets placed in escrow as part of a tax free exchange of

assets.

3. By including the escrowed assets in the net worth statement of the Plaintiff, the Court erred as this resulted in substituting the Court's judgment for that of the majority of the shareholders of the Plaintiff who, with complete disclosure of all relevant facts, had consciously chosen to take advantage of the escrowed tax free exchange of property for value reasons. The Court's opinion has the effect of abrogating the escrow agreement and the hard-fought, negotiated settlement between the Street Clinic and the Sisters of Mercy and Mercy Regional Hospital.

In our view all three of these issues are interrelated because the resolution of all of them depends on whether the chancellor correctly interpreted the term "intangible asset" as it was included in Paragraph A., Article III. of the Stock Agreement. If he erred when he found that \$2,628,814 in cash, \$140,000 worth of land, and interest of \$26,766 which the cash deposited in escrow earned during the calendar year 1990 were not intangible assets within the meaning of Paragraph A., Article III of the Stock Agreement, then this Court must reverse the Final Judgment which the chancellor entered. We therefore elect to consider and to evaluate all three issues simultaneously.

### **Standard of Review**

*Madden v. Rhodes*, 626 So. 2d 608, 616 (Miss. 1993) contains a succinct explanation of the standard of review appropriate in matters of chancery:

On appeal this Court will not reverse a Chancery Court's findings, be they of ultimate fact or of evidentiary fact, where there is substantial evidence supporting those findings. We must consider the entire record before us and accept all those facts and reasonable inferences therefrom which support the chancellor's findings. The findings will not be disturbed unless the chancellor abused his discretion, was manifestly wrong or clearly erroneous, or an erroneous legal standard was applied. And the chancellor, being the only one to hear the testimony of witnesses and observe their demeanor, is to judge their credibility. He is best able to determine the veracity of their testimony, and this Court will not undermine the chancellor's authority by replacing his judgment with its own. (citations omitted).

In the case *sub judice*, we confront the issues of whether the chancellor erred (1) by not requiring Drs. Walker and Rankin to deliver their shares of stock to The Street Clinic pursuant to the formula contained in the Stock Agreement, (2) by directing The Street Clinic to increase Drs. Walker and Rankin's stock values to \$150,561 to include the value of the assets placed in escrow as part of the tax-deferred exchange of assets, and (3) by including the escrowed assets in the net worth statement of The Street Clinic. Unless the three assets of \$2,628,814 in cash, \$140,000 worth of land, and interest of \$26,766 were "intangible assets" as intended in Paragraph A., Article III of the Stock Agreement, we must affirm the chancellor.

### **Discussion of the Issues**

In *Kight v. Sheppard Bldg. Supply, Inc.*, 537 So. 2d 1355 (Miss. 1989), the supreme court contended with whether the trial judge was correct in awarding judgment to a materials supplier, Sheppard Building Supply, Inc., against the owner of an apartment complex, Kight, into the construction of

which its building supplies had gone. *Id.* at 1356. The general contractor, Britt, had not paid Sheppard; but he and Kight had executed an agreement by which they agreed that Kight would pay Britt's suppliers directly from the proceeds of the contract to build the apartment complex as Britt earned them. *Id.* at 1357. The supreme court noted that the problem with the agreement was that it did not state either the amount Kight was to pay Britt's sub-contractors who were listed in the agreement or the duration of their agreement. *Id.* The supreme court affirmed the judgment against Kight, owner of the recently constructed complex. *Id.* at 1359. That court noted, "As regards our standard of appellate review, the interpretation of an ambiguous writing by resort to extrinsic evidence presents a question of fact. *Dennis v. Searle*, 457 So. 2d 941, 945 (Miss. 1984)." *Id.* at 1358.

The Mississippi Supreme Court reversed in part the chancellor's grant of summary judgment for the vendors of a home damaged by termite infestation in a case which involved the interpretation of the contract for the sale of the home in *Dennis v. Searle*, 457 So. 2d 941, 947 (Miss. 1984). The supreme court stated:

Where a contract is clear and unambiguous, its meaning and effect are matters of law which may be determined by the court. On the other hand, where the contract is ambiguous and its meaning uncertain, *questions of fact are presented which are to be resolved by the trier of the facts after plenary trial on the merits.*

*Id.* at 945 (emphasis added). In the case *sub judice*, The Street Clinic contends that the assets in escrow were intangible and properly excludable from its 1990 financial statement because the asset for which they were substituted, the 1982 Agreements with the Sisters, which included the Building Agreement, were also of no value. Drs. Walker and Rankin counters that because the assets of cash and land were held in an escrow agreement, a consequence of which might well be to defer the payment of income tax on the proceeds of the Clinic's settlement with the Sisters, they were no less tangible. Thus, according to Drs. Walker and Rankin, these assets in escrow ought to have been included in the Clinic's 1990 financial statement. We have already summarized the expert opinions adduced by these litigants to support their respective arguments.

The ambiguity of the term "intangible assets" created a question of fact for the chancellor to resolve. He resolved that question of fact favorably to Drs. Walker and Rankin. Pursuant to our previously cited standard of review, we should affirm the chancellor's determination of this question of fact question unless we can conclude that no substantial evidence supported his determination; or that the chancellor abused his discretion, was manifestly wrong or clearly erroneous; or that he applied an erroneous legal standard to the facts which he found from the evidence. In its brief, the Clinic asserts:

In this case the trial court's findings of fact are not the problem. The factual conclusions, as a whole, are correct. It is the application of the law and the ultimate conclusions reached by the learned chancellor that are in error.

Our understanding of *Kight* and *Dennis* compels us to disagree with the Clinic's evaluation of the chancellor's error as an error of law. Instead we deem the issue of error to be an issue of fact -- and not one of law.

The striking similarity of the issues in *Mathews Brake Hunting & Fishing Club, Inc. v. Sneed*, 475

So. 2d 811 (Miss. 1985) to the issues in the case *sub judice* persuades this Court that the chancellor in this case must be affirmed. In *Sneed*, Dr. Woodford W. Sneed and eleven others formed Mathews Brake Hunting & Fishing Club, Inc. for the stated purpose of acquiring and holding lands and waters for hunting, fishing and trapping, establishing game and fish preserves and maintaining and operating a private hunting and fishing club for the use and recreation of the stockholders and guests. *Id.* at 812. In 1964 the corporate charter was amended to allow the corporation to engage in farming operations on the corporation's land or to lease and rent land to others. *Id.* The club had been capitalized by the issuance of twelve shares of common stock, one to each of the club's charter members. *Id.* Each of them paid \$500 for his share. *Id.*

At a special meeting of the Board of Directors on March 20, 1953, the following amendment to the by-laws was proposed:

Stock is non-transferable. In the event of the death of a stockholder, or other reasons satisfactory to a majority of the stockholders, stock shall be surrendered to the corporation in consideration of payment of book value. Book value shall be determined by a vote of the stockholders at each annual meeting, and only at each annual meeting. Disposition of stock shall be determined by a majority vote of stockholders at the regular annual meeting and only at the regular annual meeting.

*Id.* Between 1953 and 1974 stock was surrendered to the club on at least nine times pursuant to the provisions of this amended by-law. *Id.* When Dr. Sneed died on March 15, 1974, the Club evaluated his share of stock at \$4,132.89. *Id.* Ralph Sneed, executor of Dr. Sneed's estate, refused to accept the Club's offer because he thought that the dramatic increase in the worth of duck-hunting land in the Delta had increased the value of the testator's share of stock far in excess of the price which the Club had established pursuant to the previously recited by-law. *Id.*

Just as the Clinic did in the case *sub judice*, the Club filed suit in the Chancery Court of Leflore County to obtain specific performance by the executor. *Id.* Alternatively, the Club sought a declaration from the court that Dr. Sneed's estate was estopped to assert the invalidity of the by-law because of the decedent's acquiescence in the club's practice during his life. *Id.* At the trial, an expert testified that because of "tremendous demand" for it, the Club's land was worth \$274,343 at Dr. Sneed's death and \$589,255 at the time of trial. *Id.* Thus, in the thirteen-member club, the testator's share of stock would have been worth approximately \$21,000 at his death and \$45,325 at trial. *Id.* at 812-13.

The chancellor issued a decree for the defendant executor, Ralph Sneed. *Id.* at 813. The chancellor found that:

[T]he by-law in question had been invalidly adopted, and could not be enforced under any contractual theory because the agreed-upon price constituted grossly inadequate consideration. He also held that because of the terrific increases in the price of Delta land occurred after Dr. Sneed's supposed acts of acquiescence, his estate was not estopped from attacking the restriction. He further refused to require the appellee to surrender his share of stock to the appellant at the price offered.

*Id.* On appeal, the supreme court opined:

This Court will not reverse a chancellor's ruling on a controverted issue of fact unless it is evident from the record that he was manifestly wrong. We are of the opinion, and so hold, that under the facts of this case there was substantial evidence supporting the chancellor's finding of fact and it will not be disturbed. Accordingly, the decree of the chancellor is affirmed.

*Id.* The similarities between *Sneed* and the case *sub judice* are: (1) the corporation's attempt to enforce the surrender of a share of its stock pursuant to the corporation's interpretation of its by-law and (2) the shareholder's refusal to surrender the share because the shareholder disputed the corporation's low evaluation of that share's value. Were this Court to reverse the chancellor's decree in the case before us, it would appear that it had ignored the doctrine of *stare decisis* because it failed to apply the supreme court's resolution of the issues in the *Sneed* case to the facts and issues in this case.

We resolve its first two issues adversely to the Clinic. Now we consider its third issue, whether the chancellor "substituted the Court's judgment for that of the majority of the shareholders . . . who had consciously chosen to take advantage of the escrowed tax free exchange of property for valid reasons;" and thus "abrogat[ed] the escrow agreement." On this issue, the chancellor found:

In the absence of any agreement to the contrary, an instrument or deed held in escrow by a third party (bank) does not take effect until its final or second delivery. However, Mississippi recognizes the rule "whenever justice or necessity demands resort to fiction to ward off intervening claims or liens, a court of equity will give a relation back and cause it to take effect from its first delivery as an escrow." The Court has very carefully examined Exhibit 27, Escrow Agreement. Medical Center deposited \$2,628,814.00 and an executed deed. Street Clinic deposited a conveyance instrument conveying its interest in the Building Agreement and a parking easement. Escrow Agent was to thereafter enter into contracts for the construction on a new building for Street Clinic to be completed by May 1, 1991 or October 25, 1991, if not completed by the earlier date. The construction was for the benefit of Street Clinic. In the event construction was not complete, Escrow Agent was to assign construction contracts to Street for completion. Any excess costs over and above escrowee sums were the obligation of Street. Street Clinic had the right to approve almost every act of the Escrow Agent, including construction. Nothing of consequence remained for Street Clinic to do except await the final completion of the building. As a result, *the Court concludes that Street Clinic had at the very minimum on November 1, 1990, an equitable interest in the assets deposited by Mercy Center into the escrow agreement with minimal actions required of Street to complete the escrow.* (citations omitted) (emphasis added).

Was the chancellor manifestly wrong when he concluded that "Street Clinic had at the very minimum on November 1, 1990, an equitable interest in the assets deposited by Mercy Center into the escrow agreement with minimal actions required of Street to complete the escrow." The Clinic offers this Court only the case of *Wood v. Morath*, 128 Miss. 143, 90 So. 714 (1922) to support its argument on its third issue. In *Wood*, the owner and lessor of a house and lot, Wood, delivered his warranty deed to a bank to hold it in escrow until such time as his lessee, Brasher, complied with the terms of their lease-purchase agreement. *Wood*, 90 So. at 714. The lessee's compliance with the agreement

would require the bank as escrow agent to deliver the owner-lessor's warranty deed to the lessee. *Id.* During the five year period covered by the agreement, the owner-lessor allowed another party, Morath, to succeed to the original lessee's obligation under the agreement. *Id.* at 715. In the meantime the municipal ad valorem taxes assessed against the subject property were not paid for one year; and one Holmes purchased the house and lot from the municipal tax collector. *Id.*

When Holmes' municipal tax deed matured, he demanded that the successor lessee surrender possession of the land to him. *Id.* The successor-lessee, Morath, filed suit against Holmes, the tax purchaser, and the original lessor-owner, Wood. *Id.* The successor-lessee sought to cancel Holmes' tax deed; but were he unsuccessful against Holmes, then he sought to recover against Wood, the owner-lessor, on his warranty of title to Morath. *Id.* Wood defended Morath's claim under the warranty on the grounds that under the original lease-purchase agreement, he was not responsible for liens for unpaid taxes against nor for tax sales of the subject property which occurred after he had delivered the warranty deed to the bank as escrow agent. *Id.* The supreme court noted that the real question in the case was "When did the warranty become effective? Did it become effective when the deed was delivered by [Wood] to the bank, or when the deed was delivered by the bank to [Morath]?" *Id.* The supreme court held that the warranty took effect with Wood's delivery to the bank; but this case alone is insufficient to persuade this Court that the chancellor in the case *sub judice* ought to be reversed on the Clinic's third issue.

The chancellor found that the Clinic had an equitable interest in the escrowee funds sufficient to warrant their inclusion in the Clinic's 1990 financial statement. Earlier we quoted from the Clinic's brief that the chancellor's "factual conclusions, as a whole, are correct. It is the application of the law and the ultimate conclusions reached by the learned chancellor that are in error." As a matter of law we cannot say that the chancellor incorrectly applied law or equity to the evidence when he concluded that the Clinic had an equitable interest in the escrowee funds sufficient to warrant their inclusion in the Clinic's 1990 financial statement.

#### **IV. Conclusion**

During the course of the trial, the chancellor observed, "I think all these terms are works of art as far as accounting procedure is concerned. [This] is what the problem is." "The problem" was the ambiguity of the term "intangible assets" as used in Paragraph A., Article III of the Stock Agreement. The Mississippi Supreme Court has held several times that questions of ambiguity are matters of fact to be resolved by the trier of fact, who in this case was the chancellor. This court finds from the chancellor's detailed findings of fact and conclusions of law, which he based on precedent cited in his conclusions of law, that he resolved "the problem" without error in light of the appropriate standard of review established for matters heard in chancery. He observed the witnesses, evaluated their testimony, and concluded that \$2,628,814 in cash, \$140,000 worth of land, and interest of \$26,766 were "tangible assets" which ought to be included in the Clinic's 1990 financial statement and thus in the value of Drs. Walker and Rankin's shares of stock in the Clinic in accordance with Paragraph A., Article III of the Stock Agreement.

The Clinic has raised no issue about any other matter which the chancellor adjudicated in the Final Judgment which he rendered on January 19, 1994, including the determination that "[T]he adverse position resolution [regarding the payment of attorneys' fees by Clinic members who litigated against

the Clinic] contravenes Article VII of the Stock Agreement and is unenforceable." Of the several cases which we have discussed in this opinion, *Mathews Brake Hunting & Fishing v. Sneed* seems most factually similar and legally relevant to the issues which the Appellant, The Street Clinic, has presented for our consideration and determination. As the supreme court affirmed the chancellor's decree in *Sneed*, so do we affirm the chancellor's Final Judgment in the case *sub judice*.

**THE JUDGMENT OF THE WARREN COUNTY CHANCERY COURT IS AFFIRMED.  
COSTS ARE ASSESSED TO APPELLANT.**

**FRAISER, C.J., BRIDGES AND THOMAS, P.J.J., BARBER, DIAZ, KING, McMILLIN,  
PAYNE, AND SOUTHWICK, JJ., CONCUR.**