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CORPORATIONS -ACCOMMODATION OBLIGATIONS - EFFECT OF "GUARANTEE" IN POWERS SECTION OF STATUTE

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COMMENTS

CORPORATIONS — ACCOMMODATION OBLIGATIONS — EFFECT OF "GUARANTEE" IN POWERS SECTION OF STATUTE — Section 10-i of Act 327 of the Michigan Public Acts of 1931 provides:[1]

> "Every corporation . . . shall have power: to guarantee, purchase, hold, sell, assign, transfer, mortgage, pledge or otherwise dispose of, the shares of the capital stock of, or any bonds, securities or evidence of indebtedness created by, any other corporation. . . . *Provided,* That any corporation organized or doing business in this state under this act shall not have the power to guarantee or anywise become surety upon any bond or other undertaking securing the deposit of public moneys. . . ."

[1] This section was amended by Mich. Pub. Acts (1933), no. 186, by the addition of an excepting clause, but the quoted text remains the same and the problem presented is in no wise altered.

In an action involving a claim by a receiver grounded upon the accommodation indorsement by the defendant corporation of the paper of another corporation presumably a stranger to it, the judge stated by way of dictum:[2]

> ". . . the court is inclined to interpret the statute of Michigan as including power to execute accommodation papers. Members of the committee which drafted the 1931 Michigan Code state that the power to guarantee does not extend to accommodation undertakings, but in 14a Corpus Juris, 734, it is said that: 'The power to issue or indorse accommodation paper will be implied, however, from an express or implied power in the corporation to become surety or guarantor. . . .' "[3]

It has long been settled that as a general rule no power exists in a corporation to become an accommodation obligor.[4] But the rule is not inflexible, for the power does exist if all the stockholders authorize the transaction and no rights of creditors are jeopardized; also, where the transaction is reasonably necessary to the furtherance of the corporate purposes stated in the articles of incorporation, such power may be implied.[5]

The court in the principal case recognized the general prohibition against corporate accommodation obligations but held the defendant liable on the theory of consent of the stockholders. With this portion

[2] Thomas v. E. G. Curtis Sons Co., (D. C. Mich. 1934) 7 F. Supp. 114.

[3] This discussion is directed solely to the implication of the power to accommodate from the power to guarantee. It is not concerned with implications of the power to accommodate from the power to become a surety.

[4] For the purpose of this discussion, "accommodation" means lending of credit without consideration; "guaranty" means the lending of credit for a consideration. The terms are so used by the courts in dealing with the lending of corporate credit, and it is a safe assumption that the legislatures adopted that usage. See for example: In re New York Car Wheel Works, (D. C. W. D. N. Y. 1905) 141 Fed. 430; Hare & Chase v. Commonwealth Discount Corp., 260 Mass. 134, 156 N. E. 893 (1927); La Grange Lumber and Supply Co. v. Farmers' & Traders' Bank, 37 Ga. App. 409, 140 S. E. 766 (1927). On the power of a corporation to become an accommodation obligor, see: 6 FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS, sec. 2631 (1931); 3 THOMPSON, COMMENTARIES ON THE LAW OF CORPORATIONS, sec. 2300 (1927); 4 COOK, A TREATISE ON THE LAW OF CORPORATIONS, sec. 774 (1923); Nat. Bank of Shamokin v. Waynesboro Knitting Co., 314 Pa. St. 365, 172 Atl. 131 (1934); O'Brien v. Turner, 174 Wash. 266, 24 Pac. (2d) 641 (1933).

[5] Conferring of the power by consent: 6 FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS, sec. 2632 (1931); 3 THOMPSON, COMMENTARIES ON THE LAW OF CORPORATIONS, sec. 2301 (1927); 4 COOK, A TREATISE ON THE LAW OF CORPORATIONS, sec. 774 (1923).

Implication of the power: 3 THOMPSON, COMMENTARIES ON THE LAW OF CORPORATIONS, sec. 2301 (1927); 6 FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS, secs. 2486-90 (1931).

of the opinion the writer has no quarrel. But exception is taken both to the interpretation given to the statute by the court and the accuracy of the principle relied upon, as expressed in the dictum quoted.

Assuming (but not admitting) that the power to guarantee as provided in the statute includes the power to enter into accommodation obligations, it is plain that the scope of the latter cannot exceed that of the former. This points, naturally, to an inquiry into judicial interpretation of statutory provisions identical with or similar to the one in question. Provisions of this type exist today in sixteen States[6] but are, unfortunately, so recent as to preclude any imposing regimentation of authority. What few cases there are indicate that the word "guarantee" in a section like that of the Michigan statute is merely declarative of the situation which existed prior to its insertion, and which still exists in the State, where such a provision is absent, namely, that a corporation may guarantee corporate bonds, securities or evidences of indebtedness only where the exercise of such power is deemed necessary to and in furtherance of its business.[7] Aside from the possibility of predicating an argument on the implications of the proviso in the Michi-

[6] Ark. Sess. Laws (1931), c. 255, sec. 7; Del. Rev. Code (1915), c. 65, sec. 77; Fla. Comp. Gen. Laws (1927), sec. 6534; Idaho Code (1932), sec. 29-114d; Ann. Ind. Stat. (1933), sec. 25-202; La. Gen. Stat. Ann. (1932), sec. 1092-j —"unless otherwise provided in the articles, to accomplish its purposes as stated in the articles, a corporation may guarantee shares, bonds, contracts, securities and/or evidences of indebtedness of any other domestic or foreign corporation, including interest and/or dividends thereon. . . ."; Mich. Pub. Acts (1931), no. 327, sec. 10-i; Minn. Laws (1933), c. 300, sec. 9 —"When so provided in its articles of incorporation a corporation may acquire, hold, mortgage, pledge or dispose of the shares, bonds, securities and other evidences of indebtedness of any domestic or foreign corporation; and, without such authority in its articles, may guarantee, acquire, hold, mortgage, pledge, or dispose of the shares, bonds, securities and other evidences of indebtedness of any domestic or foreign corporation when reasonably necessary or incidental to accomplish the purposes stated in its articles." Nev. Comp. Laws (1929), sec. 1608 as amended by Nev. Laws (1931), c. 224, sec. 6; N. Mex. Stat. (1929), sec. 32-301 (requires two-thirds vote of stock subscribed and outstanding to authorize the guarantee); Ann. Code of Ohio (1930), sec. 8623-8; Penn. Laws (1933), no. 106, sec. 301 (6), p. 379 (prefaced by, "Whenever appropriate to enable it to accomplish any or all of the purposes for which it is organized. . . ."); Tenn. Code (1932), sec. 3722 (8); Va. Code (1930), sec. 3777 (h); Wash. Laws (1933), c. 185, sec. 12 (prefaced by, "A corporation, to accomplish its purpose as stated in the articles of incorporation. . . ."); W. Va. Code (1931), c. 31, art. 1, sec. 65. See also Cal. Civ. Code, 1933 Supp., sec. 366, as amended by Cal. Stats. (1933), c. 533, sec. 67; ELDRIDGE, NEW YORK STOCK CORPORATION LAW, sec. 19 (1923).

[7] Eckhart v. Guardian Nat. Bank of Commerce of Detroit, (D. C. Mich. 1934) 6 F. Supp. 376; Norfolk Mattress Co. v. Royal Mattress Co., 160 Va. 623, 169 S. E. 586 (1933); Hayes v. State ex rel. Oldroyd Mach. Co., 124 Ohio St. 485, 179 N. E. 402 (1931); 8 UNIV. CINN. L. REV. 302 (1934).

See for an interpretation of the word "guarantee" when present in the article or by-laws though not in the statute: Food Products Co. v. Pierce, 154 Va. 74, 152

gan statute,[8] support for this interpretation is to be found in the principle that a statute declares the law previously existing unless it unambiguously revokes the law. The interpretation is further strengthened by the position of the word "guarantee" in the statutes. In each case the word appears in the section dealing with the power of a corporation to hold, acquire, and dispose of the securities and evidences of indebtedness of other corporations. Before such an enactment became common, a recognized judicial exception to the prohibition against corporate guarantees, which in large measure resembled that against accommodation obligations, existed where the corporation guaranteed in order to negotiate further corporate securities, other than its own, acquired in the regular course of business. In such case the power was implied; and where there is no similar statutory provision it is still implied as in furtherance of the corporation's business, the basis for the implication being the provision giving the power to acquire and dispose of such securities and obligations.[9]

In light of the preceding discussion, proceeding still on the assumption that the authority cited by the court is accurate, the ability of a corporation to become an accommodation obligor under the statute would be limited to the situation where it would be in furtherance of the business of the corporation to engage itself as guarantor. Thus,

S. E. 562 (1930); Steiner v. Steiner Land & Lumber Co., 120 Ala. 128, 26 So. 494 (1898).

Note also the language of the Louisiana, Minnesota, Pennsylvania, and Washington statutes quoted supra, note 6. And for an opinion of a member of the drafting committee of the Michigan act, see WILGUS & HAMILTON, MICHIGAN CORPORATION LAW, pp. 83 and 89 (1932).

[8] The proviso is unique with the Michigan act. The tenor of the argument would be that where a type of transaction is excepted out of preceding general language by a proviso, that transaction would be within the act but for the exception; that since the exception concerned the power to "guarantee or anywise become surety upon any bond or other undertaking securing the deposit of public moneys," other general types of guarantee would be within the purview of the act, the quoted activity being of a general type of guarantee. But the presence of the proviso is by no means conclusive — it may be explained as a provision dictated by an excess of caution. See 2 LEWIS'S SUTHERLAND, STATUTORY CONSTRUCTION, sec. 351 (1904). It is at most something to consider in arriving at a reasonable interpretation of the act.

[9] 6 FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS, sec. 2594 (1931), and cases there collected. See particularly, McFerson v. Kepner, 76 Colo. 523, 233 Pac. 148 (1925); Pollitz v. Pub. Util. Comm. of Ohio, 96 Ohio St. 49, 117 N. E. 149, L. R. A. 1918D 166 (1917).

For the implied power of a corporation to guarantee in general, see Labatt, "Power of Corporations to Execute Guaranties," 31 AM. L. REV. 363 (1897); Clark, "Guarantee by One Corporation of the Obligations of Another," I CORP. PRAC. REV. 67 (June 1929); 6 FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS, secs. 2588-2596, 2719 (1931); 4 COOK, A TREATISE ON THE LAW OF CORPORATIONS, sec. 775, p. 3538, n. 3 (1923).

except for the possibility that a court might find a guarantee of corporate bonds, securities, or evidence of indebtedness necessary to the business of the corporation on a given set of facts where an accommodation would not be so considered, which is conceivable, there could be no advantage in linking up accommodations with a statutory provision of the type in question. An identical result could be reached on orthodox theories of implication of corporate powers, unencumbered by a process of logical substitution of equivalent terms. On either approach, if the factual assumption in the principal case is correct that the corporation accommodated was a stranger whose paper had not been acquired in the ordinary course of business, clearly, such a linking could not help the court.

Moreover, the accuracy of the principle that a corporate power to guarantee implies a parallel power to accommodate is open to question. Theoretically, accommodation obligations and guarantees (as the terms are used in this field) are sufficiently dissimilar in their incidents to preclude any necessary implication of the power to enter into the former from the power to enter into the latter.[10] In view, therefore, of the established antipathy of courts toward accommodation obligations, and in the absence of any economic factor making a change of policy necessary or desirable, one would naturally expect that a corporate power to guarantee would *not* include the power to accommodate. These expectations are borne out in a measure by the presence of a few cases leaning in such a direction and the absence of any case to the contrary.[11] Examination of the cases cited in support of the proposition relied on by the court discloses them as not supporting it in the general sense in which it was applied.[12]

[10] Waller v. Gorman Mercantile Co., (Tex. Civ. App. 1911) 141 S. W. 833; In re New York Car Wheel Works, (D. C. W. D. N. Y. 1905) 141 Fed. 430; Hare & Chase v. Commonwealth Discount Corp., 260 Mass. 134, 156 N. E. 893 (1927); La Grange Lumber and Supply Co. v. Farmers' and Traders' Bank, 37 Ga. App. 409, 140 S. E. 766 (1927).

[11] See cases cited supra, note 10. Also Food Products Co. v. Pierce, 154 Va. 74, 152 S. E. 562 (1930); Steiner v. Steiner Land & Lumber Co., 120 Ala. 128, 26 So. 494 (1898).

For an opinion in accord with the argument, see WILGUS & HAMILTON, MICHIGAN CORPORATION LAW, pp. 83 and 89 (1932). The authors were members of the committee which drafted the Michigan Act. There is a statement in 6 FLETCHER, CYCLOPEDIA OF THE LAW OF CORPORATIONS, sec. 2631, pp. 453-4 (1931), similar to the Corpus Juris citation. But no authority is cited beyond a reference to the chapter dealing with general principles of guarantee.

[12] Holmes, Booth & Haydens v. Willard, 125 N. Y. 75, 25 N. E. 1083, 11 L. R. A. 170 (1890) — suit by a corporation to collect damages from its treasurer who had executed accommodation paper in favor of another corporation. He had previously negotiated a contract with the latter corporation to purchase its entire output of manufacture. Held, that the treasurer was guilty of no *ultra vires* act, the lending of credit

It would seem, therefore, that:

(1) Apparently there is no support in the cases for the principle that a power in a corporation to guarantee implies a parallel power to accommodate.

(2) Even if the correctness of that principle is assumed, the instant type of statutory provision would not ground unlimited power to execute accommodation obligations in favor of strangers, for

(3) The inclusion of the word "guarantee" in the powers section of a corporation confers a power to guarantee only when reasonably necessary to further major corporate purposes.

L. H. W.

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being incidental to the business of the corporation, and therefore based on an implied power of the corporation which the treasurer could exercise. Nothing is said of any power to become a guarantor from which the power to become an accommodator might be implied.

In re New York Car Wheel Works, (D. C. W. D. N. Y. 1905) 141 Fed. 430 —a corporation which owned all the stock of another corporation sought to evade liability on accommodation indorsements in favor of the latter, on the theory it was outside its powers to enter into such obligations. Held, that due to the interest of the indorser corporation in the other there was here a lending of credit on consideration amounting to a guarantee and not an accommodation, which guarantee was in exercise of its implied powers. The case is clearly no authority for the principle as stated.

Bankers' Trust and Audit Co. v. Hanover Nat. Bank of New York, 35 Ga. App. 619, 134 S. E. 195 (1926)—the corporation's charter stated a power to ". . . buy and sell . . . and otherwise deal and traffic in stocks, bonds, securities, and other obligations of other corporations . . . to aid in any manner any other corporation whose stock, bonds, or other obligations are held or in any manner guaranteed by said corporation, and to do any other act or thing for the preservation, protection, improvement or enhancement of the value of any such stocks, bonds, or other obligations. . . ." Held, the corporation had the charter power to become a surety or accommodation indorser upon the note of another corporation *in which it owned stock*. This again is purely a matter of implying powers in view of corporate purposes. It is so treated in FLETCHER'S CYCLOPEDIA OF CORPORATIONS. The court says nothing of implying the power to accommodate from the power to become a guarantor.

Kennemer-Willis Grocery Co. v. Hacker, 225 Ala. 415, 143 So. 821 (1932)— suit by a payee of a note against a wholesale grocery company which had indorsed a $2000 note for a customer with the intention that the proceeds be used to pay the latter's indebtedness to it; $1800 was so applied. Held, that because of the situation ". . . the corporation is not a surety as respects the payee of the note, but is such a principal debtor as is within its implied charter powers." There is language to the effect that, looked on as an accommodation indorsement, the obligation was within the implied powers of the corporation as being incidental to its business. There is nothing concerning an admitted power to become a guarantor from which the power to indorse for accommodation might be implied.