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CORPORATIONS — EXCULPATORY PROVISION IN BOND — STOCKHOLDERS' LIABILITY FOR ILLEGAL DIVIDENDS — A bondholders' protective committee sued a holding company under a Michigan statute¹ making stockholders in street railway companies, who knowingly receive dividends in impairment of capital stock, liable for corporate debt then existing and subsequently accruing while they remain stockholders. The defense relied on was a "no recourse" clause in the bonds wherein the creditors waived their rights to any assessment whatsoever "against any incorporator, stockholder, officer or director of the railway company, or any successor corporation." Held, the "no recourse" clause waived only liabilities where the defendant acted in good faith; not where the defendant acted fraudulently in knowingly receiving illegal dividends. *Abercrombie v. United Light and Power Co.*, (D. C. Md. 1934) 7 F. Supp. 530.²

A creditor may waive his right to impose liability upon a stockholder either for unpaid subscriptions in absence or because of statute or for additional statutory liability.³ Such waiver is not against public policy, because stockholders' liability, whether statutory or constitutional, is not in favor of the corporation or the

¹ Mich. Comp. Laws (1929), sec. 11313.

² The corporation's receiver had by prior suit recovered dividends as thus illegally paid. *Guaranty Trust Co. v. G. H. & M. Ry.*, 7 F. Supp. 511 (1931).

³ See generally 40 A. L. R. 371-374 (1926); 13 FLETCHER, CYCLOPEDIA OF CORPORATIONS, Perm. ed., sec. 6422 (1932); 1 COOK, CORPORATIONS, 8th ed., sec. 216 (1923); 4 THOMPSON, CORPORATIONS, 2d ed., sec. 4764 (1909). Such waiver may be a "no recourse" clause in a bond. *Continental Corp. v. Gowdy*, 283 Mass. 204, 186 N. E. 244 (1933); *Marfield v. Cincinnati, D. & T. Traction Co.*, 111 Ohio 139, 144 N. E. 689 (1924). The "no recourse" clause need not appear on the bond but may be incorporated by reference to the mortgage instrument. *Rosoff v. Gilbert Transportation Co.*, (D. C. Conn. 1915) 221 Fed. 972; *Babbitt v. Read*, (C. C. A. 2d, 1916) 236 Fed. 42. On the efficacy of reference provisions in bonds, see 33 MICH.

public⁴ but in favor of creditors, who consequently may waive their personal right.⁵ The court in the principal case, as have other courts,⁶ denied exculpation to the stockholders on the ground that the "no recourse" clause did not contemplate waiver of liabilities not incurred in good faith.⁷ The impolicy of permitting stockholders to escape liability imposed by the legislature is apparent where, as in the principal case, they have knowingly taken illegal dividends. It is somewhat less apparent that the investing public, for example stockholders who have been guiltless of misfeasance and who are without any real control over corporate officers, should incur liability.⁸ It has been argued, where there was no fraud, that bondholders are protected by the scrutiny given security issues by bankers and brokers, from whom the public at large purchase securities and upon whom they rely for integrity, and who in turn must depend upon the public for good will and patronage.⁹ This suggests the actual situation, which is that the average individual bondholder does not read the "no recourse" clause, nor does he know of or rely on the stockholders' peculiar liability.¹⁰ It is submitted, therefore, that

L. REV. 604 (1935). Creditors may waive stockholders' liability as a condition to the assignment of assets to a composition of creditors, *O'Donnell Shoe Co. v. Benson Co-op. Mercantile Co.*, 175 Minn. 382, 221 N. W. 426 (1928); *Keeling Corp. v. Pacific Products*, 138 Cal. App. 180, 31 Pac. (2d) 1043 (1934), or to a trustee for the benefit of creditors, *Robie v. Holdahl*, 175 Minn. 44, 219 N. W. 945 (1928). A "no recourse" provision in the articles of incorporation is of itself insufficient. *Van Pelt v. Gardner*, 54 Neb. 701, 74 N. W. 1083 (1898). The waiver may be *in pais*, *United States v. Stanford*, 161 U. S. 412, 16 Sup. Ct. 576 (1896), or in parol. See 40 A. L. R. 371 at 374 (1926); *Basshor v. Forbes*, 36 Md. 154 (1872); *Brown v. Eastern Slate Co.*, 134 Mass. 590 (1883); *Bush v. Robinson*, 95 Ky. 492, 26 S. W. 178 (1894).

⁴ *Lum v. American Wheel & Vehicle Co.*, 165 Cal. 657, 133 Pac. 303 (1913).

⁵ 13 FLETCHER, CYCLOPEDIA OF CORPORATIONS, Perm. ed., sec. 6422 (1932); *Marfield v. Cincinnati, D. & T. Traction Co.*, 111 Ohio 139 at 149, 144 N. E. 689 at 692 (1924); 23 MICH. L. REV. 293 (1925); *Continental Corp. v. Gowdy*, 283 Mass. 204 at 217, 186 N. E. 244 at 249 (1933); *Babbitt v. Read*, (C. C. A. 2d, 1916) 236 Fed. 42 at 44 (1916).

⁶ See generally, 40 A. L. R. 371 at 376 (1926). *Downer v. Union Land Co.*, 113 Minn. 410, 129 N. W. 777 (1911); *Preston v. Cincinnati, C. & H. Valley Ry.*, (C. C. S. D. Ohio 1888) 36 Fed. 54; *Small v. Sullivan*, 245 N. Y. 343, 157 N. E. 261 (1927). *Walker v. Howell*, 209 Iowa 823, 226 N. W. 85 (1929), likened officers of a corporation to trustees, who cannot contract against their acts of negligence or bad faith. 24 HARV. L. REV. 565 (1911) considered the possibility of waiving liability even for fraud.

⁷ *Abercrombie v. United Light & Power Co.*, 7 F. Supp. 530 at 544 (1934). But see *Continental Corp. v. Gowdy*, 283 Mass. 204 at 215, 186 N. E. 244 at 248 (1933), where there was a violation by directors of a statute identical in tenor with the one in the principal case, and the court, while denying the right to contract against fraud, upheld the validity of a similar "no recourse" clause but intimated that the bondholders might recover independently of statute for the fraudulent or wrongful acts. And see *Babbitt v. Read*, (C. C. A. 2d, 1916) 236 Fed. 42 at 46.

⁸ Ballentine, "Stockholders' Liability in Minnesota," 7 MINN. L. REV. 79, 98 (1923).

⁹ *Babbitt v. Read*, (C. C. A. 2d, 1916) 236 Fed. 42 at 44.

¹⁰ COOK, CORPORATIONS, 8th ed., sec. 215 (1923).

except in the case of large commercial creditors, who are apt to, and must, ascertain their rights, the underlying problems are, not as to the waiver of known rights, but rather, what should public policy dictate, what is the legislature's intention, and whether this intention can be given effect.

G. M. W.