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Howard N. Thiele, Jr.
University of Michigan Law School

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CORPORATIONS—OFFICERS AND DIRECTORS—LIABILITY FOR REALIZING LESS THAN FULL VALUE FROM SALE OF CORPORATE ASSETS ON DISSOLUTION—The defendants were directors, officers, and sole stockholders of a corporation engaged in the business of wholesaling electrical supplies. The business gradually declined until the corporation was no longer able to meet maturing obligations, even though expenses had been cut to a minimum. After trying unsuccessfully to borrow more money the defendants decided to wind up the business. Faced with several possible methods of liquidation, they chose to sell the

assets at an open auction sale. The net proceeds of the sale were about $20,000, while the cost of the inventory had been at least $60,000. The creditors, through the trustee in bankruptcy, sued the directors for waste of the assets under the New York statute.[1] The appellate division decided that there had been waste, for the directors had not given the required notice to the creditors of the sale and had not realized full value for the assets. On appeal, *held,* affirmed, two judges dissenting. While notice to the creditors is not required, directors must respond in damages for the amount, if any, by which less than full value is realized from the liquidation sale of a corporation's assets. *New York Credit Men's Adjustment Bureau, Inc. v. Weiss,* 305 N.Y. 1, 110 N.E. (2d) 397 (1953).

It is universally held that officers and directors of a corporation have a fiduciary relationship to that corporation and its stockholders.[2] This is often termed a relationship of trustee and cestui que trust[3] or of principal and agent.[4] Most jurisdictions hold that officers and directors do not have this fiduciary obligation to creditors when the corporation is solvent,[5] but declare that when a corporation becomes insolvent, a trust relationship arises between creditor and director.[6] Because of this fiduciary duty to the corporation, stockholders, or creditors, the director is liable for acts tinged with bad faith,[7] fraud,[8] or culpable negligence.[9] In the principal case the court was satisfied that the directors had not acted in bad faith or perpetrated a fraud, but apparently held that they were negligent as a matter of law if they could not prove they had gotten full value for the assets. This decision was made despite the general rule that the negligence of directors in suits for waste of corporate

[1] "An action may be brought against one or more of the directors or officers of a corporation to procure judgment for the following relief or any part thereof: . . . 2. To compel them to pay to the corporation, or to its creditors, any money and the value of any property, which they have acquired to themselves, or transferred to others, or lost, or wasted, by or through any neglect of or failure to perform or other violation of their duties." 22 N.Y. Consol. Laws (McKinney, 1943) §60.

[2] Remillard Brick Co. v. Remillard-Dandini Co., 109 Cal. App. (2d) 405, 241 P. (2d) 66 (1952); Des Moines Bank & Trust Co. v. George M. Bechtel & Co., 243 Iowa 1007, 51 N.W. (2d) 174 (1952); Burnes National Bank v. Mueller-Keller Candy Co., (8th Cir. 1936) 86 F. (2d) 252.

[3] Commercial Banking and Trust Co. v. Tenant's Realty Co., 37 Ohio App. 566, 175 N.E. 36 (1930); National Drama Corp. v. Burns, 183 N.Y.S. 739 (1920).

[4] Mathews v. Fort Valley Cotton Mills, 179 Ga. 580, 176 S.E. 505 (1934).

[5] Conway v. Bonner, (5th Cir. 1939) 100 F. (2d) 786; Whitfield v. Kern, 122 N.J. Eq. 332, 192 A. 48 (1937); Wilson v. Stevens, 129 Ala. 630, 29 S. 678 (1901).

[6] Tampa Waterworks Co. v. Wood, 97 Fla. 493, 121 S. 789 (1929); City National Bank v. Goshen Woolen Mills Co., 35 Ind. App. 562, 69 N.E. 206 (1903); Mica Products Co. v. Heath, 81 N.H. 470, 128 A. 805 (1925); Shoenthal v. New Jersey Gardens Co., (N.J. 1918) 103 A. 415; Olney v. Conanicut Land Co., 16 R.I. 597, 18 A. 181 (1889).

[7] Angelus Securities Corp. v. Ball, 20 Cal. App. (2d) 423, 67 P. (2d) 152 (1937); Gordon v. Pendleton, 202 N.C. 241, 162 S.E. 546 (1932).

[8] Van Antwerp Realty Corp. v. Cooke, 230 Ala. 535, 162 S. 97 (1935); Prudential Trust Co. v. McCarter, 271 Mass. 132, 171 N.E. 42 (1930).

[9] Briggs v. Spaulding, 141 U.S. 132, 11 S.Ct. 924 (1891); Flynn v. Third National Bank, 122 Mich. 642, 81 N.W. 572 (1900); Union National Bank v. Hill, 148 Mo. 380, 49 S.W. 1012 (1899).

assets is ultimately a question of fact to be determined under all the circumstances, and goes to the jury unless only one inference can be drawn from the facts.[10] The degree of negligence necessary to hold a director liable for waste varies in different states. Some jurisdictions require no less than gross negligence, at least when the directors serve without compensation.[11] Others require the care an ordinarily prudent director would use in a similar business.[12] The third and most strict rule makes the director liable if he fails to use the care which businessmen of ordinary prudence exercise in their own affairs.[13] New York adheres to this last view.[14] Under none of these three theories is a director or officer held liable for a mistake of judgment,[15] and New York itself has gone so far as to say that a director will not be held liable even though the error was so gross as to show unfitness to manage corporate affairs.[16] In the light of the negligence and mistake rule in New York it seems that interpreting the statute as requiring that full value be obtained for the assets is unreasonable, for the directors are being held liable for a mistake of business judgment.[17] It appears that the directors chose to auction the assets in the belief that it would be an inexpensive way to liquidate and did so only after consultation with an attorney and use of reasonable judgment. The court indicates that the directors were required only to act without improvident waste and need not have given notice to the creditors of the sale. However, it seems to say that the directors caused improvident depletion of the assets if they failed to get full value for them. In its interpretation of the statute the court does not apply the New York negligence rule on waste and thus does not take into account the fact that since the directors were the sole stockholders, it is especially likely that they would act with the care which a businessman of ordinary prudence uses in his own affairs.[18] From the cases relied upon in

[10] 3 FLETCHER, CYC. CORP., perm. ed., §1030 (1947).

[11] Medford Trust Co. v. McKnight, 292 Mass. 1, 197 N.E. 649 (1935); Van Antwerp Realty Corp. v. Cooke, note 8 supra; Jones v. Johnson, 86 Ky. 530, 6 S.W. 582 (1888).

[12] Pool v. Pool, (La. 1945) 22 S. (2d) 131; Anderson v. Bundy, 161 Va. 1, 171 S.E. 501 (1933); Atherton v. Anderson, (6th Cir. 1938) 99 F. (2d) 883.

[13] Strauss v. U.S. Fidelity and Guaranty Co., (4th Cir. 1933) 63 F. (2d) 174; Martin v. Hardy, 251 Mich. 413, 232 N.W. 197 (1930); Burkhardt v. Smith, 161 Md. 398, 157 A. 299 (1931).

[14] Kavanaugh v. Gould, 223 N.Y. 103, 119 N.E. 237 (1918); Hanna v. Lyon, 179 N.Y. 107, 71 N.E. 778 (1904); General Rubber Co. v. Benedict, 215 N.Y. 18, 109 N.E. 96 (1915).

[15] Casey v. Woodruff, 49 N.Y.S. (2d) 625 (1944); Spiegel v. Beacon Participations, 297 Mass. 398, 8 N.E. (2d) 895 (1937); South Penn Collieries Co. v. Sproul, (3d Cir. 1931) 52 F. (2d) 557; Fagerberg v. Phoenix Flour Mills Co., 50 Ariz. 227, 71 P. (2d) 1022 (1937).

[16] Everett v. Phillips, 26 N.Y.S. (2d) 881, 43 N.E. (2d) 18 (1941); Jersawit v. Kaltenbach, 1 N.Y.S. (2d) 756 (1938).

[17] This is essentially the position taken by Desmond, J., in his dissent in the principal case. *Contra:* 17 ALBANY L. REV. 301 (1953); 66 HARV. L. REV. 1526 (1953); 39 VA. L. REV. 690 (1953).

[18] In re Spering's Appeal, 71 Pa. St. 11 (1872). This case, though not applying the general rule used in New York, does suggest that directors who are also stockholders would naturally be more careful in their operation of the business than would directors who own no stock. The idea seems peculiarly well adapted to the principal case.

the majority opinion it would seem that the court ignored the orthodox concept of a director's fiduciary obligation,[19] and held the directors to a much higher standard of care than is usually applied to them in New York or any other jurisdiction.

Howard N. Thiele, Jr.

[19] The only three cases cited in the majority opinion are Meinhard v. Salmon, 249 N.Y. 458, 164 N.E. 545 (1928) (fiduciary relationship between partners in a joint venture); Wendt v. Fischer, 243 N.Y. 439, 154 N.E. 303 (1926) (fiduciary relationship between real estate broker and client); Matter of Ryan's Will, 291 N.Y. 376, 52 N.E. (2d) 909 (1943) (fiduciary relationship between trustee and beneficiary under a will).