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# Corporations

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*zelius* case, while perhaps rendered futile, at least was not made impossible, as in the *Pickett* case. The defendant was guilty of no more than a qualified repudiation. Moreover, plaintiff could not point in the *Corzelius* case, to the fact of the defendant's breach as a possible foundation for a presumption that the condition would have been performed, for the defendant's breach in the case was not, as in the *Pickett* case, an actual accomplishment of the object of the condition.

What, then, is the present Texas law on the point under consideration, as a result of the *Corzelius* and *Pickett* decisions? Probably the safest conclusion, in the light of all of the authorities considered, is that, as a general rule, the plaintiff must prove that a condition, alleged to have been excused by defendant's repudiation, would, in the absence of such repudiation, have been fulfilled; the *Pickett* case is probably an exception, confined to cases where the defendant has accomplished the result which the condition contemplated and has rendered impossible performance by the plaintiff.

*Robert R. Sanford.*

## CORPORATIONS

### ACQUISITION BY DIRECTORS OF OUTSTANDING CLAIMS AGAINST CORPORATION

*Arkansas.* In *Mothershead v. Douglas et al*<sup>1</sup> a corporation owned a debt in the amount of \$45,000 secured by a mortgage. The corporation was unable to pay the debt, and the creditor agreed to accept \$15,000 in settlement. Acting in a formal meeting, the directors had the corporation execute a new sixty-day note and mortgage for the original indebtedness of \$45,000 to several of the corporation's directors who personally advanced the \$15,000. Upon maturity of this note, the lending directors sued to foreclose the mortgage, and the property secured by the mortgage brought

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<sup>1</sup> ———Ark.———, 221 S. W. 2d. 424 (1949).

\$42,500 at the foreclosure sale. Plaintiff, a stockholder, intervened. The Arkansas Supreme Court held that the lending directors had no claim against the corporation beyond the amount actually advanced by them. The court stated the general rule to be that a director of a corporation will not be permitted to acquire a claim against the corporation either when he owes it a duty of acting in its behalf and for its benefit, or when, knowing the corporation to be insolvent, he buys a claim for his own benefit, intending thereby to get an advantage over other creditors. The director has, in this situation, no claim against the corporation beyond the amount actually expended by him.

The *Mothershead* case is in accord with the general view of the courts concerning acquisition of corporate claims by directors.<sup>2</sup> Language used in the case indicates that the directors are "trustees" in handling corporate affairs. Under strict trust law, it has long been settled that a trustee cannot acquire obligations of the trust estate at a discount and enforce them at their face value.<sup>3</sup> However, courts usually recognize commercial interests in the ready transferability of corporate obligations and do not apply the strict trust rule to directors and officers of a corporation.<sup>4</sup>

Apparently the corporation was insolvent at least to the extent that it could not meet its obligations as they matured; this factor of insolvency alone is probably enough to cause most courts to limit the amount of recovery by a director to that actually expended by him in acquiring the claim.<sup>5</sup> If it is for the interest of the corporation to take up its obligations at a discount, and it is financially able to do so, a director should not be permitted to buy

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<sup>2</sup> *Horner v. New South Oil Mill*, 130 Ark. 551, 197 S. W. 1163 (1917); *Bonney v. Tilley*, 109 Cal. 346, 42 Pac. 439 (1895); *Young v. Columbia Land and Investment Co.*, 53 Ore. 438, 99 Pac. 936, 101 Pac. 212, 133 Am. St. Rep. 844 (1909).

<sup>3</sup> *Jose v. Lyman*, 316 Mass. 271, 55 N. E. 2d. 833 (1944).

<sup>4</sup> *Inglehart v. Thousand Island Hotel Co.*, 32 Hun. 377 (N. Y. App. Div. 4th Dept. 1884); *McIntyre v. Ajax Mining Co.*, 28 Utah 162, 77 Pac. 613 (1904).

<sup>5</sup> *Monroe v. Scofield*, 135 F. 2d. 725 (C.C.A. 10th, 1943); *In re Philadelphia and Western Ry. Co.*, 64 F. Supp. 738 (Dist. Ct. E. D. Pa. 1946); *In re McCrory Stores Corp.*, 12 F. Supp. 267 (Dist. Ct. S. D. N. Y. 1935); *Davis v. Rock Creek Lumber, Flume and Mining Co.*, 55 Cal. 539, 36 Am. Rep. 40 (1880).

the obligations at a discount and enforce them in full without first offering the opportunity to the corporation.<sup>6</sup> In the *Mothershead* case an offer apparently was made first to the corporation, since a formal directors' meeting was called which authorized the liquidation of the claim by the lending directors.

Although not discussed by the court, the record seems to indicate that this particular directors' meeting was subject to the application of the generally accepted "interested directors" rule to the effect that a contract authorized on behalf of a corporation is voidable unless there is a disinterested quorum and a voting majority and the director successfully bears the burden of showing the fairness of the transaction.<sup>7</sup> Four directors were present at the meeting, and three of them were promisees in the note and mortgage.

The principle used by some courts<sup>8</sup> to the effect that a director may become a creditor of a corporation and enforce his claims by the same methods as any other creditor but that the contract by which he became a creditor is subject to the strictest scrutiny and will be enforced only when fair and equitable is probably as precise a statement as is possible. This generalization recognizes desirable commercial elasticity and at the same time prevents exploitation by a director of his fiduciary position. In the *Mothershead* case the fact that the property brought a much greater amount on the foreclosure sale than the amount advanced by the directors and the further fact that the note and mortgage were only for a sixty-day period undoubtedly would have their influence on the court in applying the above principle.

#### DISPOSAL OF LEASE AND OPTION ASSETS UPON DISSOLUTION OF CORPORATION

*Texas.* In *Nardis Sportswear v. Simmons*<sup>9</sup> the Texas Supreme Court had before it a suit for specific performance of an option to

<sup>6</sup> *Higgins v. Lansingh*, 154 Ill. 301, 40 N. E. 362 (1895).

<sup>7</sup> *McKittrick v. Ark. Cent. Ry. Co.*, 152 U. S. 473 (1894).

<sup>8</sup> *Coombs v. Barker*, 31 Mont. 526, 79 Pac. 1 (1905).

<sup>9</sup> 147 Tex. 608, 218 S. W. 2d. 451 (1949).

purchase a business building. Plaintiffs were the directors of a lessee corporation. At the time of the suit, although a certificate of dissolution had been issued by the Secretary of State,<sup>10</sup> the directors had not completed the liquidation, winding up, and distribution of corporate assets to the stockholders. The terms of the lease provided that it was non-assignable, but that the lessee had an option to purchase the building at any time during the life of the lease. The directors of the dissolved corporation notified defendant that the corporation desired to exercise the option to purchase the building, and after a few preliminary negotiations the defendant refused to sell. The present suit for specific performance resulted. Defendant lessor contended that Articles 1359, 1388, and 1389 of the TEXAS REVISED CIVIL STATUTES (VERNON, 1925) prevented the exercise of the option to purchase. The court, however, granted specific performance.

The proper determination of the issues in this case requires an inquiry into the power and authority of the directors and managers of a dissolved corporation, keeping in mind restrictions in the lease contract between the lessor and lessee. In order to determine that power and authority reference must be had to Article 1388, which delineates the permissible power. The portion of the statute which is relevant gives the directors and managers power to (1) settle the affairs, (2) collect the outstanding debts, (3) divide the moneys and other property among the stockholders, and (4) exercise full power and authority of said company over such assets and property. Article 1389 continues the existence of the corporation for three years in order that the corporation may settle up its affairs.

At common law, dissolution of the corporation was regarded as the death of a fictitious person; corporate realty reverted to the grantor and personalty escheated to the state.<sup>11</sup> As noted in the

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<sup>10</sup> TEX. REV. CIV. STAT. (Vernon, 1925) art. 1387-4 provides: "When, without a stockholders' meeting, all the stockholders of the corporation consent in writing to a dissolution, the same shall be certified to as above and filed with the Secretary of State. . . ."

<sup>11</sup> 47 A.L.R. 1288 (1927).

*Nardis* case, Texas courts, even in absence of statutory authority, adhered to the doctrine that all the assets of a dissolved corporation are protected by equity as a trust fund for creditors and stockholders.

In *McBride v. Clayton*<sup>12</sup> the Texas Commission of Appeals held that a dissolved retail merchandising corporation could not enforce an insurance policy on the life of its former president, who had no duties to perform in the dissolved corporation's affairs, since the corporation had no "insurable interest" in the life of its inactive former president. The commission of appeals construed Articles 1388 and 1389 to limit the powers of the directors of a dissolved corporation strictly to those purposes set out in the statutes. The commission said:

"Although the statutes give McBride Inc. a continued existence for as long as three years after the surrender of its charter, it clearly could not be so continued *to purchase and sell goods, wares, and merchandise and to transact a general retail mercantile business.*"<sup>13</sup> (Italics by the court.)

Thus, it would appear that the transaction of any business in furtherance of the purpose for which the corporate charter had been granted other than for settling up its affairs is beyond the scope of the directors' powers. It has long been the rule in Texas that contract rights based upon valuable consideration will survive dissolution for the benefit of the stockholders.<sup>14</sup> Apparently, then, a dissolved corporation may enforce any contractual asset which is in existence at the time of dissolution even though such enforcement would involve the *acquisition and subsequent disposition* of real or personal property. One of the defendant's contentions in the *Nardis* case was lack of consideration for the option to purchase; the court of civil appeals overruled this contention, holding

<sup>12</sup> 140 Tex. 71, 166 S. W. 2d. 125 (1942). The opinion of the commission of appeals was adopted by the supreme court.

<sup>13</sup> *Id.* at 75, 166 S. W. at 128.

<sup>14</sup> *International and Great Northern Ry. Co. v. State*, 75 Tex. 356, 12 S. W. 685 (1889); *Sulphur Springs and Mt. Pleasant Ry. Co. v. St. Louis A. & T. Ry. Co.*, 2 Tex. Civ. App. 650, 22 S. W. 107 (1893), *writ of error refused*.

that the obligation to pay rent was adequate consideration.<sup>15</sup> It appears that if an option to purchase is not supported by valuable consideration, it is a mere offer to sell. In light of the limitation on the powers of a dissolved corporation, an acceptance of an offer to sell would probably be construed as transaction of new business and thus unauthorized, since it would not seem to fall within the language of the statute as "settling the affairs" or of exercising "full power and authority" over assets and property. Judicial interpretation of the statute has been rather meager. It is at least questionable whether a third person can challenge the existence of a dissolved corporation during the three-year term provided for in Article 1389. It provides that the existence of every corporation may be continued for three years after its dissolution from whatever cause for the purpose of enabling those charged with the duty to settle up its affairs. Since the *existence* of the corporation is continued, it is possible that as to third persons there has been no dissolution sufficient to affect the obligations due the corporation and that corporate limited liability continues for that three-year period.

The directors of a dissolved corporation are entitled to the use of discretion in liquidating the corporate assets.<sup>16</sup> In the principal case the directors had a choice of either paying the balance due of approximately \$19,000 on the unexpired portion of the lease or exercising the option to purchase for \$75,000. This exercise of discretion by the directors was apparently justified.

American courts have held that a lease to a corporation is not terminated by dissolution of the corporation whether the dissolution be voluntary<sup>17</sup> or involuntary.<sup>18</sup> In a New Hampshire case<sup>19</sup> an option to purchase contained in a non-assignable lease was en-

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<sup>15</sup> *Nardis Sportswear v. Simmons*, 213 S. W. 2d. (Tex. Civ. App. 1948).

<sup>16</sup> *Tenison v. Wilson*, 151 S. W. 2d. 327 (Tex. Civ. App., 1941), *writ of error dismissed*.

<sup>17</sup> *Kalkhoff v. Nelson*, 60 Minn. 284, 62 N. W. 332 (1895).

<sup>18</sup> *People v. St. Nicholas Bank*, 151 N. Y. 592, 45 N. E. 1129 (1897).

<sup>19</sup> *Conn v. Manchester Amusement Co.*, 79 N. H. 450, 111 Atl. 339 (1920).

forced; however, that case is distinguishable since the dissolution was by legislative act and not voluntary as in the principal case. In view of the holding of the Texas Supreme Court, a lessor who desires to avoid the exercise of an option to purchase should clearly provide in the lease contract that neither the lease nor option shall survive corporate dissolution, whether the dissolution be voluntary or involuntary. Without restrictive clauses in the lease contract, even if no actual assignment is made by the dissolved corporation, under the language of the statute, the directors may "divide the moneys and *other property* among the stockholders." Thus, there is nothing in the statute which would prohibit the directors from exercising the option and leaving the stockholders as tenants in common of the newly-acquired property. The theory of dissolution is that the associated individuals still own all of the property but do so as tenants in common without the attributes provided by the corporation laws; apparently the only rights which are lost upon dissolution are the privileges and rights peculiar to corporations. Since there is no requirement in the Texas statutes that the assets be reduced to cash, the stockholders probably can become and *remain* tenants in common of the unexpired lease term and enforce that right as well as exercise the option to purchase, unless the lease contains restrictions to the contrary.<sup>20</sup>

In the *Nardis* case defendant claimed that the dissolved corporation could not exercise the option to purchase, since it would violate Article 1359, which in essence limits the acquisition of land by a Texas corporation to those lands necessary to enable the corporation to do business or to secure an indebtedness due the corporation. The court of civil appeals held that this article had no application to dissolved corporations. The supreme court quoted the article but did not discuss the point. In previous Texas decisions this article has been construed as being applicable only to suits instituted by the State.<sup>21</sup> The court of civil appeals opinion

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<sup>20</sup> *Cumington Realty Associates v. Whitten*, 239 Mass. 313, 132 N. E. 53 (1921).

<sup>21</sup> *Atlas Petroleum Corp. v. G. H. and S. A. Ry. Co.*, 5 S. W. 2d. 215 (Tex. Civ. App. 1928); *Knowles v. Northern Texas Traction Co.*, 121 S. W. 232 (Tex. Civ. App. 1909); *Ray v. Foster*, 53 S. W. 54 (Tex. Civ. App. 1899).