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COMMENTS

LIABILITY OF OFFICERS AND DIRECTORS WHO CONTINUE THE BUSINESS OF A CORPORATION AFTER FORFEITURE OF ITS CHARTER

Borbein Young & Co. v. Cirese, 401 S.W.2d 940 (Mo. Ct. App. 1966)

Defendants were officers and directors of a firm of trailer manufacturers incorporated under the laws of Missouri which in 1954 forfeited its charter. The defendants continued to operate as they had prior to the forfeiture, and in the years following the loss of charter, they purchased parts and materials from the plaintiff company until 1960 when the defendants’ company was adjudged bankrupt. At this time they owed plaintiff over $10,900 on open account. The plaintiff sued the individual officers and directors of the defunct company who were in office at the time of the forfeiture claiming that they were personally liable for all debts incurred by them because they had continued to operate the business after the loss of its charter.

Plaintiff’s suit was based upon a Missouri statute which makes the officers and directors who are in office at the time of forfeiture trustees of the company for the purpose of winding up its affairs.¹ The trial court found against all four of the defendants for the full amount of the debt owed plus interest. Two appealed, claiming they were neither officers nor directors of the company at the time the debt to the plaintiff was incurred, and therefore, should not be held liable. The appellate court held that the personal liability of the defendants arose from their neglect of duty as trustees to liquidate the corporation and distribute its assets at the time of charter forfeiture. Having failed in this duty and continuing to operate the business of the corporation, they became individually liable for debts even though they might have terminated their active participation prior to incurrence of the obligation.²

¹ '[T]he directors and officers in office when any such forfeiture occurs shall be the trustees of the corporation, who shall have full authority to wind up its business and affairs, sell and liquidate its property and assets, pay its debts and obligations and to distribute the net assets among the shareholders; and such trustees as such shall have power to sue for and recover the debts and property due such corporation, describing it by its corporate name, and may be sued as such; and such trustees shall be jointly and severally responsible to the creditors and shareholders of such corporation to the extent of its property and effects that shall have come into their hands. Mo. Rev. Stat. § 351.525 (1959).

² Borbein Young & Co. v. Cirese, 401 S.W.2d 940, 944 (Mo. Ct. App. 1966). However, in this particular case the court did find that there was sufficient evidence presented to show that the appellants were officers and directors of the corporation at the
The court in *Borbein Young & Co. v. Cirese*, relied upon *Leibson v. Henry* as the original authority for the interpretation of the Missouri statute in question. *Leibson* held, on similar facts, that the officers and directors of a corporation which had forfeited its charter became trustees of said corporation with full power to liquidate the corporation's affairs for the benefit of the stockholders and creditors. However, as trustees, they were powerless to transact any of the corporation's business, except to wind up its affairs; and if they did act beyond their powers and continue the business as had been done prior to forfeiture, the defendants were to be held personally liable for any obligations incurred by them in such unlawful assumption of power.\(^5\)

The court in *Borbein Young* expanded on this decision, explaining that the vital date as to the personal liability of officers and directors is the date the charter was forfeited, not the date the debt was incurred.\(^5\) Therefore, if the defendant was an officer or director at the time of forfeiture of the charter and subsequently resigned his post (prior to the incurrence of the debt) he would still be held personally liable for the obligation. This is a reasonable interpretation of the statute if the law of trustees is applied. A trustee, having manifested his intent to assume the trust duties\(^7\) can only be relieved of them by a resignation which is accepted by the beneficiaries or by a court of competent jurisdiction, and cannot merely resign on his own

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3. 401 S.W.2d 940 (Mo. Ct. App. 1966).
4. 356 Mo. 953, 204 S.W.2d 310 (1947).
6. The personal liability of officers and directors of a dissolved corporation arises from their neglect of duty as trustees to liquidate the corporation and distribute its assets *at the time of charter forfeiture*. If they fail in that statutory duty and unlawfully continue to operate the business of the corporation after its dissolution they would remain individually liable for corporation debts even though incurred at a time subsequent to their active participation in business affairs on behalf of the corporation. So it is that the vital date . . . is the date of forfeiture—not when "the account sued on was contracted." *Borbein Young & Co. v. Cirese*, 401 S.W.2d 940, 944 (Mo. Ct. App. 1966).

*But see Schwab v. Schlumberger Well Surveying Corp.*, 145 Tex. 379, 198 S.W.2d 79 (1946) (directors held not to be liable for a note renewed after charter forfeiture on a debt which had been incurred prior to the forfeiture). *Contra*, *Hicks v. Continental Carbon Paper Mfg. Co.*, 380 S.W.2d 737 (Tex. Civ. App.), *aff'd per curiam*, 382 S.W.2d 910 (Tex. 1964) (director who had retired prior to incurrence of the debt held not to be liable for it).

7. Such manifestation is implicit in acceptance of a position as a corporate officer or director since upon their election they are charged with knowledge of any duties they may incur because of their position. Consequently, an officer or director of a Missouri corporation who continues in the same role after forfeiture of the corporate charter is, by statute, considered to have accepted a trusteeship.
Corporations are creations of statutes and it is within the almost unlimited power of the legislature to prescribe rules for their creation and dissolution. It is likewise for the legislature to determine what penalties shall be imposed on the corporation and the officers who manage it for failure to comply with laws regarding payment of license taxes. Such penalties may be imposed personally against the officers or directors if it is so desired.10

The various rationales for the enactment of such statutes include the desire to prevent fraud on the stockholders and creditors of the corporation,11 to insure prompt payment of franchise taxes to the states,12 and to abrogate the common law rule that all property of a dissolved corporation escheats to the state, leaving the creditor no one against whom he can enforce his claim.13 Since personal liability for all debts incurred may attach, these statutes are highly penal in nature14 and must be strictly construed by
the courts.\textsuperscript{15} Their application is, thus, restricted to situations which are expressly described in the particular statute.\textsuperscript{16}

All jurisdictions provide for an involuntary dissolution of a corporation by, or on behalf of, the state on specified grounds,\textsuperscript{17} but few states have enacted statutes providing for joint and several liability of officers and directors who continue the business after such forfeiture.\textsuperscript{18} In the absence of a post-forfeiture statute, some states enforce personal liability based on other principles of law: the liability of an agent who contracts for a non-existent principal,\textsuperscript{19} or a trustee who exceeds his statutory powers.\textsuperscript{20} However, not all states which impose liability necessarily include those who were directors at the time of forfeiture. Instead, for the director to be held liable, the debt must have been “created or incurred, with his knowledge, approval and consent. . . .”\textsuperscript{21} When the defendant directors did not take any part in the creation of, and did not approve a debt for goods purchased after the charter forfeiture, they were not held liable;\textsuperscript{22} but if they did approve

\textsuperscript{15} Farmers Elevator Co. v. Winschel, 88 S.W.2d 574 (Tex. Civ. App. 1935), held that the statute in question imposes partnership liability only upon directors of a corporation who undertake to carry on the business of the corporation after its right to do business has been forfeited for failure to pay franchise tax. But cf. Struders Oil Co. v. Bienfang, 22 N.J.L. 238, 4 A.2d 787 (1939) (the fact that the directors were unaware of the dissolution of the corporation does not affect their liability under the statute).

\textsuperscript{16} See Schwab v. Schlumberger Well Surveying Corp., 145 Tex. 379, 198 S.W.2d 79 (1946). It has been held, however, that this type of statute will place personal liability upon a director who has continued the business of a corporation which has forfeited its charter even though the charter has been reinstated. Moore v. Rommel, 233 Ark. 989, 350 S.W.2d 190 (1961) (restoration to corporate status restores the corporation only to the position it was in at the time of payment of the tax); Wallace v. Pere Marquette Fiberglass Boat Co., 2 Mich. App. 605, 141 N.W.2d 383 (1966) (officers and directors of a corporation are liable for any debts contracted during the period of neglect to file the annual report); Poritzky v. Wachtel, 176 Misc. 633, 27 N.Y.S.2d 316 (1941) (to allow a director to avoid post-forfeiture liability after charter reinstatement would allow him to shift the personal liability the law would otherwise impose upon him). But see Spector v. Hart, 139 So. 2d 923 (Fla. Dist. Ct. App. 1962) which held that restoration shall be effective from the date of cancellation of the charter. Since the purpose of the statute is solely the raising of revenue for the state, it would be inequitable to permit third persons who had dealt with the corporation during the period of non-existence to lose their cause of action against the directors merely because a revival statute allowed reinstatement to corporate status.

\textsuperscript{17} Statutes collected in ABA-ALI Model Bus. Corp. Act. § 87, Comment ¶¶ 2.02 & 6 (1960).


\textsuperscript{19} Struders Oil Co. v. Bienfang, 22 N.J.L. 238, 4 A.2d 787 (1939).


of a debt, although they did not create it, knowledge of the facts was presumed and the directors were held liable for it.\textsuperscript{23}

Keeping in mind the purposes of the statute\textsuperscript{24} and the fact that other jurisdictions do not enforce personal liability on directors who were in office at the time of charter forfeiture and who subsequently resigned their position, it is questionable whether the harsh interpretation placed on the Missouri statute is a proper one to achieve the ends the legislature had in mind. The statute was not passed merely to place liability on someone who may have committed a wrong, but rather to give the injured person (be it the State or an individual creditor) a remedy against the ones who improperly gained possession of his goods or money. Thus, the statute must be interpreted so as to do equity between the parties; that is, to see that the defrauded creditor has someone from whom to seek redress, while, at the same time, protecting one who may have the appearance of a wrongdoer, but who is actually an innocent party. It follows that had the two defendants in \textit{Borbein Young} been found not to have been officers or directors at the time the obligation was incurred, they should not have been held liable for the debt.

If the statute was enacted to prevent a fraud on the creditors of the corporation,\textsuperscript{25} then why should one who has had no part in the perpetration of a fraud and who, at worst, simply disassociated himself from the corporation, be held liable? Surely so long as the injured creditor has someone to look to for a remedy there is no reason to place liability on one who did not act in concert with the others or who may not have had knowledge of the breach of trust.\textsuperscript{26} At least one state has gone so far as to hold that the purpose of the statute is to prevent wrongful acts of culpable officers and directors of a corporation and to protect the public, not to punish officials who have taken no part in the malfeasance of the other directors.\textsuperscript{27} In an analogous situation—pre-incorporation liability—most state statutes provide that a director shall not be held personally liable for pre-incorporation acts which co-directors may have ratified, if he properly dissents from them in writing to the appropriate authority, or if he merely records his dissent in the minutes of the directors’ meeting at which the


\textsuperscript{24} Text accompanying notes 11-13 \textit{supra}.

\textsuperscript{25} Leibson v. Henry, 356 Mo. 953, 204 S.W.2d 310 (1947).


\textsuperscript{27} Schwab v. Schlumberger Well Surveying Corp., 145 Tex. 379, 198 S.W.2d 79 (1946).
proposed illegal action was discussed. 28 Cases supporting this proposition have held that equitable principles may not be disregarded, and that when the violation of the statute has not been the direct and proximate cause of the injury complained of the non-participating director cannot be held personally liable. 29 The liability of a director should be the same for post-forfeiture acts of other directors as for pre-incorporation misdeeds of co-directors. 30

If the statute had been enacted for the purpose of raising revenue for the state and insuring prompt payment, 31 again there is no need to impose liability on one who participates in no further business of the corporation which is to be dissolved. The only penalty that should be imposed on such person is one for not completing his statutory duty of winding up the affairs of the corporation. In imposing this penalty, the courts should determine if the accused director, who claims innocence, has extinguished his possible remedies 32 to force the other directors to liquidate the affairs of the business. Such acts on his part would show good faith in his actions thus giving the courts just cause for limiting his liability. Even if the director has not sought such remedies, no more than a fine should be imposed on him for


29. See Baker v. Bates-Street Shirt Co., 6 F.2d 854 (1st Cir. 1925); Third Nat'l Bank v. Martin, 219 Ky. 579, 293 S.W. 1064 (1927) (one cannot be held liable merely because another has violated the statute). A person's violation must be the proximate cause of the plaintiff's loss for him to be held liable for such injury.

30. Text accompanying notes 21-23 supra.

31. Isbell v. Gulf Union Oil Co., 147 Tex. 6, 209 S.W.2d 762 (1948).

32. There are two possible remedies available to the director: obtaining an injunction to enjoin his fellow directors from carrying on the business of the corporation and seeking a writ of mandamus ordering such directors to wind up the affairs of the corporation.

An injunction is a proper remedy if the remedy at law is inadequate or if irreparable harm would befall the person seeking the injunction if it were not granted, e.g., Baltimore Transit Co. v. Flynn, 50 F. Supp. 382 (D. Md. 1943), but it will not be granted merely for an apprehension or fear a loss, Donnelly Garment Co. v. Dubinsky, 55 F. Supp. 587 (W.D. Mo. 1944), aff'd, 154 F.2d 38 (8th Cir. 1946). If the court finds, however, that a situation such as the one presented in the Borbein Young case is one in which there is only an apprehension and no irreparable damage is imminent, the director may succeed in suing for a writ of mandamus.

A writ of mandamus may be issued at the court's discretion since "it is . . . the appropriate remedy to enforce the performance of duties imposed on artificial bodies, including . . . private corporations." F. Ferris & F. Ferris, Jr., Extraordinary Legal Remedies § 192 (1926). It is proper for a corporation to obtain a writ of mandamus to require officers to perform ministerial duties owed to the corporation. Cf. Lydia E. Pinkham Medicine Co. v. Gove, 305 Mass. 213, 25 N.E.2d 332 (1940). Also one may bring mandamus to enforce payment of taxes owed by the corporation. Cf. Murphy v. Jos. Hollander, Inc., 131 N.J.L. 165, 34 A.2d 780 (1943).
neglect to close out the business.\textsuperscript{33}

Concerning the abrogation of the common law rule,\textsuperscript{34} the purpose of the statute is to prevent the property from escheating to the state, thus providing the injured party a right of action against the persons who presently have control of the property. It would therefore be illogical to allow him to maintain a suit against the individuals who have had no part in the preservation of the corporation's business. Since the directors who have continued doing business have wrongfully persisted in using the corporation's property (which otherwise would have escheated to the state), it seems that it should be only these persons who are held liable to the defrauded creditor.

If taken literally, the Missouri statute could be interpreted as the court has done, but in terms of fairness and equity, this cannot and should not be considered to be the legislative intention. The words "when any such forfeiture occurs" should have been interpreted to mean that the directors and officers who were in office at the time of forfeiture shall become trustees for the purpose of dissolution; but only those who contracted the post-forfeiture debts while acting beyond the scope of their power shall be liable for them. This interpretation would fulfill all of the purposes of the statute and still meet the requirements of fairness and equity.\textsuperscript{35}

\textsuperscript{33} E.g., LA. REV. STAT. ANN. § 12:702 (1950); Md. ANN. CODE art. 23 § 86 (1957); N.C. GEN. STAT. § 105.231 (1939).

\textsuperscript{34} Text accompanying note 13 supra.

\textsuperscript{35} United States v. Fleisher Eng'r. & Constr. Co., 30 F. Supp. 961 (W.D. N.Y. 1939) (statutes are not to be so literally construed as to defeat the purpose of the legislature, and should receive a construction so as to avoid an unjust conclusion); Commissioner v. Meyer, 139 F.2d 256 (6th Cir. 1943) (common sense plays its part in construing statutes).