1971

Equitable Life and Casualty Insurance Comp Any, a Utah Corporation v. Inland Printing Company, a Utah Corporation; D. Keith Barnes; Wendell Barnes; H.J. Barnes, et al. : Brief of Respondents Barneses

Utah Supreme Court

IN THE SUPREME COURT OF THE STATE OF UTAH

EQUITABLE LIFE AND CASUALTY INSURANCE COMPANY, A Utah Corporation,

Plaintiff-Appellant,

vs.

INLAND PRINTING COMPANY, A Utah Corporation; D. KEITH BARNES; WENDELL BARNES; H. J. BARNES, Et Als.,

Defendants-Respondents.

Case No. 12255

BRIEF OF RESPONDENTS BARNESES

Appeal from the Second District Court in and for Davis County, State of Utah
Honorable Henry Ruggeri, Judge

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NATURE OF CASE

This is a mortgage foreclosure action against a corporate entity in which Plaintiff-Appellant also seeks to recover a deficiency judgment against Directors of the

Company on the grounds of their alleged negligent management of the corporate affairs.

DISPOSITION IN LOWER COURT

Plaintiff-Appellant's original Complaint was filed on April 15, 1968, and named only Inland Printing Company as Defendant in a mortgage foreclosure action.

On March 10, 1970, Plaintiff-Appellant filed an Amended Complaint naming Defendants with conflicting lien priorities, officers and Respondent Barnes' as Directors along with other Directors as Defendants. On or about March 27, 1970 these Respondents filed a motion to dismiss Complaint moving the Court to: (1) dismiss the action because the Complaint fails to state a claim against said Defendants upon which relief can be granted; and, (2) dismiss the action against said Defendants upon the ground that they had been improperly [redacted]joined as parties Defendant. An order granting Plaintiff's Motion to Dismiss was signed on May 28, 1970, which order provided that Plaintiff would have Twenty (20) days from May 25, 1970 in which to file another Amended Complaint. Plaintiff-Appellant did file a second Amended Complaint dated June 10, 1970, and these Respondents again filed a motion to dismis the Second Amended Complaint which motion was dated July 23, 1970 and based upon the same grounds as set forth in the first motion to dismiss.

The Court heard oral arguments again on August 18, 1970, and signed an order of dismissal on August 24, 1970 without provision for filing another amended Complaint.

RELIEF SOUGHT ON APPEAL

These Respondents seek an affirmance of the District Court's order of dismissal dated August 24, 1970.

STATEMENT OF FACTS

During November, 1961, Defendant Inland Printing Company, a Utah Corporation, executed and delivered to Plaintiff certain promissory notes secured by chattel and real property mortgages. These documents were executed by Lloyd E. Anderson as "President and Manager of the Corporation."

None of these documents was signed by any of the Respondents nor do their names appear anywhere thereon nor did they make, execute or deliver any collateral or associated documents in connection therewith.

On April 15, 1968 Plaintiff-Appellant filed a Complaint naming only Inland Printing Company, a Utah Corporation, as Defendant which Complaint was in all

respects strictly a mortgage foreclosure action. The default of Inland Printing Company was entered on May 2, 1968.

Plaintiff-Appellant's original Attorney evidently withdrew and new Counsel entered his appearance on March 6, 1970, and moved the Court for an order setting aside the default of Defendant Inland Printing Company which order was granted.

That motion stated that it was " . . . a foreclosure action against real and chattel property and that it is necessary that other parties be named in this action so that all necessary parties can be given notice of this action. . . ." The Order granting the Motion stated that Plaintiff had leave to file an Amended Complaint ". . . naming therein all necessary parties. . . ."

Plaintiff-Appellant filed its Amended Complaint on March 10, 1970 which named defendants with conflicting lien priorities and also named Defendants-Respondents as new Defendants and claimed as damages against them the amount of the deficiency judgment, if any, on the foreclosure action and based such claim upon their alleged "negligent" management of the corporate affairs.

These Defendants-Respondents filed a Motion to Dismiss Complaint dated March 27, 1970 moving the Court: "(1) to dismiss the action because the Complaint fails to state a claim against said Defendants upon which relief can be granted; and, (2) to dismiss the action

against said Defendants upon the ground that they have been improperly enjoined as parties-Defendant." This Motion to Dismiss was granted and an Order entered on May 28, 1970 which provided that Plaintiff-Appellant would have Twenty (20) days in which to file another Amended Complaint.

Plaintiff-Appellant filed its Second Amended Complaint on or about June 10, 1970 and Respondents-Defendants filed a second motion to dismiss which was based upon the same grounds and dated July 23, 1970.

The Court again heard oral arguments on the motion and granted said motion in favor of Respondents-Defendants and entered an Order to that effect dated August 24, 1970.

ARGUMENT

POINT I

THE TRIAL COURT ACTED PROPERLY IN GRANTING DEFENDANTS' MOTION TO DISMISS PLAINTIFF'S SECOND AMENDED COMPLAINT.

Appellant has spent the better part of its entire brief with argument and citations of authority in support of legal axioms and principles whch have never been dsputed by Respondents and which are not dis-

puted now. Respondents fully agree that when a motion to dismiss a Complaint for "failure to state a claim upon which relief can be granted" under Rule 12(b) (6) of the Utah Rules of Civil Procedure is filed, the material allegations of the Complaint are to be taken as admitted; however, conclusions of law and unwarranted deductions of fact are not admitted, *Rasmussen vs. Sevier Valley Canal Company*, 40 U. 371, 121 P. 741; *Gunnison Irr. Co. vs. Peterson* 74 U. 460, 280 P. 715; *Hurst vs. Highway Department*, 16 U. 2d 153, 397 P. 2d 71; *Cessna Finance Corp. vs. Mesilla Valley Flying Service, Inc.*, 81 N.M. 10, 462 P. 2d 144; *2A Moore's Federal Practice* § 12.08.

We are in agreement with the proposition that under the notice theory of pleading, the Complaint must only give the opposing party fair notice of the nature and basis or grounds of the claim and a general indication of the type of litigation involved. Respondents do not claim that they did not have adequate notice and knowledge of the nature of Appellant's claim as pleaded in its First Amended Complaint and Second Amended Complaint. Appellant fails to realize that we are not concerned with the question of whether or not the pleadings afforded adequate notice of the nature of the claim. The contention of Respondents, with which the lower Court agreed in granting two separate Motions to Dismiss, is that under the *law* of the State of Utah as applied to the *facts* pleaded the Appellant has not made out a claim for which any relief can be granted.

In essence, Appellant has alleged that as a secured creditor of the corporate entity it is entitled to recover deficiency judgment on a mortgage foreclosure against corporate directors for their negligent management of the corporation.

It is the position and contention of Respondents that corporate creditors cannot recover from directors of the corporation any indebtedness incurred as a corporate obligation on the grounds that such directors were negligent in managing the affairs of the corporate debtor.

Appellant attempts to controvert this position by citing two cases, neither of which is in point. The facts in each are totally dissimilar to the case at bar.

In *Hoggan & Hall & Higgins, Inc. vs. Hall*, 18 U. 2d. 3, 414 P. 2d. 89, cited by Appellant, this Court was dealing with a situation wherein a corporate Plaintiff brought suit against two former officers and stockholders who resigned and formed their own advertising agency, upon the ground that they had tortuously violated their duty as officers and stockholders by soliciting business for their planned advertising agency from Plaintiff's customers while they were still officers and stockholders of the Plaintiff corporation. Clearly, a suit by a corporate entity against former officers and stockholders is different both in law and in fact from the case at bar.

In *Sweeney vs. Happy Valley, Inc.*, 18 U. 2d 113, 417 P. 2d 126, this Court was again dealing with a factual situation not relevant to the issues at bar. The situ-

ation in that case was that Plaintiff and Defendant had a fiduciary relationship in which they jointly contracted for the development of some real estate in southeast Salt Lake County. Plaintiff as beneficiary brought suit against Defendant for an accounting. The rule which Plaintiff refers to in the quote in its brief but which is not quoted is set forth as follows, and is found at Page 129 Vol. 417 of the *Pacific Reporter, Second Series*:

> "We do not question the rule that when a *fiduciary* deals for his own interest with the *beneficiary*, in case any question arises, such dealings should be scrutinized with great care, and the burden is upon him to show good faith in the transaction. This rule applies in favor of the stockholders of a corporation as against its officers, but it does not ordinarily extend to a creditor." [Italics added.]

The Court went on to find that the trial Court was justified in refusing to accept the Plaintiff's contention of fiduciary responsibility to him and was, therefore, correct in applying ". . . the general rue that the burden of proving fraud was upon the Plaintiff who asserted it." It is, therefore, clearly evident that the Court would apply the rule referred to above on behalf of creditors only when there was proof of a fiduciary responsibility between the Plaintiff and the Defendant and that it would not do so otherwise. It may be argued inferentially that the Court in effect said that in the absence of a fiduciary relationship between the creditor and the corporate directors, the creditor must allege and carry the burden of proving fraud against directors in order to recover against them for corporate liabilities.

In any event, it is clear that there is no fiduciary relationship between directors of a corporate moragagor and a mortgagee debtor unless such directors agree to be bound personally on the mortgage documents which they did not do in this case. Respondents have found no authorities to support a proposition to the contrary and Appellant, which has the burden of doing so, has cited none.

Appellant has cited *19 AmJur 2d, Corporations* §§ *1276, 1336*, both of which deal with the right of the corporate entity to bring action against its officers and directors, neither of which is applicable to the present situation. *19 AmJur 2d, Corporations* § 1341 cited by Appellant under a sub-chapter entitled "L. Rights and Liabilities as to Creditors or Third Persons 1. Liabilities for Corporate Acts, Debts or Contracts," states generally in part:

> "In most instances the directors or officers of a corporation are not liable to its creditors or third persons for corporate acts or debts. The directors or officers of a corporation are not liable for corporate acts and debts simply by reason of their official relation to the corporation; they are merely the agents of the corporation and on principal, should no more be held liable therefor than any other agent should be held liable for the acts and debts of his principal."

* * * *

The law in support of Respondents' position is well stated in *19 AmJur 2d, Corporations* § *1350* under a sub-chapter entitled "Liability for Mismanagement, Waste or Diversion of Assets" as follows:

"Directors or officers may be liable *to the corporation or stockholders* for mismanagement of the business of the corporation or waste of its assets; but according to a number of cases, *they are not liable to its creditors for mere mismanagement* or waste of assets constituting a wrong or breach of duty as to the corporation. The rule generally followed by the authorities is that *a creditor of a corporation may not maintain a personal action at law against the officers or directors of a corporation who have, by their mismanagement or negligence, committed a wrong against the corporation to the consequent damage of the creditor*. The reason given for the rule is the entire lack of privity between the parties. There is certainly no contractual relation between them, nor any other legal relation which would raise a duty, on the part of directors or officers, to the creditor to exercise care in the management of the affairs of the corporation. The duty to exercise diligence and care is one owed to the corporation, and it is elementary law that one person cannot maintain an action against another for a wrong to a third person which injures him only incidentally. However, there are other cases which seem to hold an opinion contrary to the general proposition as expressed above. These actions seem to be maintained upon the theory that directors are trustees for creditors, *but generally these cases have some element of fraud and deceit involved therein*. Statutory provisions may permit actions by creditors against corporate officers in the case of mismanagement, and in a proper case, a creditor may maintain a suit in equity. Of course, *a creditor may have an action at law for fraud and deceit*, but such an action is based upon a wrong personal to the creditor, and not a wrong consequent upon the breach of the duty owing to the corporation

to manage its affairs and assets properly. [Italics added.]

That was a statement of what Respondents have contended all along, namely, that in the absence of any allegations of fraud and deceit, creditors cannot maintain an action against corporate directors for their mismanagement of corporate affairs. That was the primary basis of Respondents' first Motion to Dismiss and even though Appellant's Second Amended Complaint was substantially more prolix than the first, it was again unwilling or unable to state a claim upon which relief could be granted and the Second Amended Complaint was also dismissed.

An annotation entitled "Ribht of Creditor of Corporation to Maintain Personal Action Against Directors or Officers for Mismanagement" found at *50 ALR 462* asks the question:

> "Assuming such negligence or other breach of duty on the part of the directors as would render them personally liable at the suit of the corporation or anyone suing in its right, may a creditor maintain a suit against them, not in the right of the corporation, but in his own right, on the theory that the ultimate consequence was a loss to him?"

After stating that cases dealing with claimants who were fraudulently or deceitfully induced by directors to extend credit to the corporation were not included in the annotation, the question is answered as follows:

> "While there is some confusion on the subject, it may be stated, with some assurance, that a cred-

itor of a corporation may not maintain a personal action, at law, against the officers or directors of a corporation, who have, by their mismanagement or negligence, committed a wrong against the corporation to the consequent damage of the creditor." (Citing cases.)

It has been held that the directors of a corporation are responsible to the corporation, *and not to its creditors* for breaches of duty in discharging their functions as corporate directors. *Pritchard vs. Myers*, 174 Md. 66, 197 A. 620, 116 ALR 775.

In the case of *Inter-Ocean Casualty Company vs. Leccony Smokeless Fuel Company*, 123 W. Va. 541, 17 SE 2d 51, 137 ALR 488 the West Virginia Supreme Court said:

"Moreover, the record here does not disclose any active misfeasance on the part of Moran and Jarett as officers and directors of the coal company. Certainly they received no benefit from the failure of their corporation to account for and pay over the amount of the premiums to the insurance company. In this state it is well settled that the creditor of a monied corporation cannot maintain an action at law against the directors thereof for simply nonfeasance of duty to the corporation or fraud in its management or mismanagement in the disposition of the money or property of the corporation *in the absence of an active intent to deceive or defraud the Plaintiff.*" [Italics added.]

* * * *

In *Wesley Corporation vs. Blackburn*, 107 W. Va. 519, 149 SE 22, the Court said: 'The evasion

of personal liability is a common motive prompting persons to engage in business through the instrumentality of a corporation.' And, by the same token and reasoning, neither are the directors nor officers liable in the absence of *active* wrongdoing." [Italics added.]

It has been stated that officers and directors of a corporation are not liable to the corporate creditors, *in the absence of fraud*, for negligence or mismanagement of the company's business resulting in insolvency, unless made so by charter or statute, neither of which is involved in the case at bar. ***United States Fidelity & Guaranty Company vs. Corning State Saving Bank*, 154** Iowa 588, 134 **NW 857.**

The position of Respondents is further supported in *3 Fletcher Cyc. Corp. (perm. ed.)* § *1193* "Liability for Debts in General" where it is stated:

> "The directors or other officers of a corporation are not liable for debts contracted in the name and on behalf of the corporation and are which binding upon it, unless they are expressly made liable by statute or unless they contract on their own behalf. This is true notwithstanding the corporation is insolvent." (Citing cases.)

* * * *

The Order of dismissal should be affirmed for the further reason that Appellant's action was a foreclosure action and that these Respondents were not "necessary parties" within the meaning of the Order of the Court dated March 6, 1970 allowing Appellant to add other

parties Defendant who had conflicting lien interests for the purpose of resolving lien priorities.

CONCLUSION

The order of dismissal entered by the Court below should be affirmed on the grounds that: (1) Appellant's Second Amended Complaint failed to state a claim against Respondents upon which relief could be granted; and, (2) Respondents were not properly joined as Defendants in the action.

Respectfully Submitted,

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