Kentucky Law Journal

Volume 39 | Issue 2 Article 8

1950

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policy enter into the adoption of such a standard. Perhaps, the benefit of well paid labor justifies employment on terms less favorable than those resulting from competition. This is the decision of the legislature as shown by its action in adopting such a standard. The only function delegated by the legislature was the finding of an economic fact which the statute applies automatically.

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FINANCIAL INABILITY AS A DEFENSE UNDER THE CORPORATE OPPORTUNITY DOCTRINE

It is a well recognized concept in the law of corporations that a director stands in a fiduciary relation to his corporation and has the duty to act in the utmost good faith to promote the corporation's interest and business. A problem of some difficulty which has emerged out of this duty of loyalty on the part of directors is the extent to which a director may take for himself a particular business opportunity which falls within the general scope of the corporation's business. In determining whether a director has the right to usurp a business opportunity the test has been said to be whether there is a specific duty to act or contract in regard to the particular matter as a representative of the corporation.[1] An important factor in determining this duty is the financial ability of the corporation to enter into the particular business transaction.

The important part financial inability may play in this respect is illustrated in the recent Kentucky case of *Urban J. Alexander Co.* v. *Trinkle.*[3] The Alexander Co. was organized in 1932 to engage in the investment and brokerage business. In 1943 Trinkle, the manager of the company secured an option in his own name to sell all the capital stock of Independent Ice and Coal Co. Trinkle was unable to obtain a purchaser and the option lapsed. A year later, Trinkle entered into a partnership with Hofgesang to purchase the stock, Trinkle obtained another option and sold the stock to the partnership. On the sale of the Independent Ice and Coal Co. the partnership realized a profit of $80,000.00. The corporation brought suit to recover one-half of the profits realized by Trinkle less commissions.

In his defense, Trinkle contended that because of the legal incapacity and financial inability of the corporation to take advantage of the opportunity, it was no longer a corporate opportunity. The charter imposed a debt limit of $250,000.00 and the corporation was practically without assets. Its credit position was such that it could not have financed the undertaking without exceeding the debt limit. The corporation had a $5,000.00 capital outlay and the transaction required $300,000.00. The debt limit imposed by the charter was a legal barrier to any transaction that would violate it. If Trinkle, as an officer, had exceeded the debt limit, he would have been liable for any loss sustained.[4] Furthermore, no bank

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[1] 3 FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS, c-11, sec. 862 (Perm. Ed. 1947).
[2] *Id.* sec. 862.1.
[3] 311 Ky. 635, 224 S.W. 2d 923 (1949).
[4] Federal Chemical Co. v. Paddock 264 Ky. 338, 94 S.W. 2d 645 (1936); Randolph v. Ballard County Bank, 142 Ky. 145, 134 S.W. 165 (1911); see Phoenix Third National Bank v. Martin, 219 Ky. 579, 293 S.W. 1064 (1927).

could safely run the risk of lending money in excess of corporation's debt limit.[5] The fact that the Independent Co. had a large amount of cash and liquid assets was no answer, for there would have had to be some financial credit before the assets would have been available as security.

In holding that the transaction was no longer a corporate opportunity, the case was disposed of on the grounds of legal incapacity. In order to establish the legal incapacity, however, Trinkle had to show the financial inability of the corporation to take advantage of the opportunity. In an earlier Kentucky case,[6] it was held that an officer of a corporation could engage in a business similar to that in which the corporation was engaged, where the corporation was insolvent and incapable of purchasing the opportunity. In that case the corporation was practically defunct. In the present case the corporation was a solvent and going concern. Nevertheless, the court said:[7]

> "While the Alexander Co. was a going concern, apparently solvent, yet its financial condition and its legal position were not sufficient to enable it to engage in this venture. The difference between this case and the Jasper case is only in degree, for the decisive point there was the incapability of the corporation."

Financial inability was obvious in the *Alexander* case; but suppose financial inability is less apparent. Will there be a temptation on the part of directors to refrain from exerting their strongest efforts on behalf of the corporation, since an opportunity of profit will be open to them personally. The leading case of *Irving Trust Co.* v. *Deutsch*[8] presents such a situation. In that case it was essential that Acoustic secure certain patents in order to continue in business. The DeForest Co. agreed to sell Acoustic the patents if it would purchase shares of DeForest stock. Acoustic, not having sufficient funds or credit, contracted to purchase the stock after an understanding with their own directors. If Acoustic were unable to purchase the stock, the directors would assume the contract; but the patents were to remain in the hands of Acoustic. Acoustic was unable to meet the payments and the directors assumed the contract. Later they sold the stock at a substantial profit and the corporation brought suit for profits realized by the directors. The lower court made a finding that Acoustic lacked funds or credit necessary for carrying out the contract and denied recovery.[9] While the circuit court refused to disturb the finding of the lower court, it did intimate that a stronger effort could have been made by the directors.[10] The court believed that this very danger necessitated the adoption of a rigid rule, forbidding directors of a solvent corporation to take for their own profit a corporate contract on the plea of corporation's inability to perform. If such a defense were sustained, an op-

[5] Phoenix Third National Bank v. Martin, 219 Ky. 579, 293 S.W 1064 (1927); American Southern National Bank v. Smith, Banking Commissioner, 170 Ky. 512, 186 S.W 482, Ann. Cas. 1918 B, 959 (1916); The First National Bank of Covington v. The D. Kiefer Milling Co., 95 Ky. 97, 23 S.W 675 (1894).

[6] Jasper v. Appalachian Gas Co., 152 Ky. 68, 153 S.W 50, Ann. Cas. 1915 B, 192 (1913).

[7] Urban J. Alexander Co. v. Trinkle, 311 Ky. 635, 642, 224 S.W 2d 923, 927 (1949).

[8] 73 F 2d 121 (C.C.A. 2d 1934). Cert. denied 294 U.S. 708, 55 S. Ct. 405, 79 L. Ed. 1243 (1938), rehearing denied 294 U.S. 733, 55 S. Ct. 514, 79 L. Ed. 1262 (1935).

[9] 2 F Supp. 971 (S. D. N.Y. 1932).

[10] 73 F 2d 121, 124 (C.C.A. 2d 1934).

portunity for profit would be opened to directors. The court flatly refused to consider the defense and adopted a rule of *uncompromising rigidity*."[11]

A high standard of loyalty should be required of directors. There is also to be considered, however, the effect the legal rules adopted will have on legitimate business transactions. It must be considered, therefore, whether an inflexible rule such as adopted in the *Deutsch* case is necessary and desirable.

Proponents of such a rule contend that if an inflexible rule is not adopted there will be wholesale disloyalty on the part of directors. However, in jurisdictions[12] which have allowed the defense there is no indication that wholesale disloyalty has resulted. Furthermore, the burden of proof as to good faith is upon the directors, and their acts are carefully scrutinized by the courts when challenged.

Another objection to adopting the more liberal rule is that it would be too easy for directors to convey the appearance of financial inability. Although financial inability may be easily simulated there are other defenses in the corporate opportunity field which are susceptible of the same charge. It would be easy to convey the appearance that a certain project was unsound, in order to get the corporation to reject the project. If the rejection was not induced by the director and he later acts for himself, the rejection by the corporation would be a defense.[13]

It is also urged that directors would use their influence to discourage credit for the corporation and it would be too difficult to determine if directors sought to secure funds. It is admitted that a director could use his influence to discourage the extension of credit to the company· but at the same time he could employ the same tactics to encourage rejection of the project. Furthermore, the burden of proof as to the fairness of the transaction would be upon the directors. They would not be required to make an exhaustive effort to secure credit, but only a reasonable and diligent effort. They would have to show that they inquired of agencies that had previously extended credit to the corporation and agencies in that locality who customarily extended credit to such firms.

There is much stress placed upon the fact that while directors are unable to secure credit for the corporation, they are able to raise money for themselves. In a great many instances a director would be able to raise money for his own benefit when it would be impossible to raise money for the corporation. This is especially true when the corporation is in failing circumstances. Furthermore, a director is under no duty to loan money to a corporation.[14]

A review of some of the decisions indicates a strong tendency to adopt the less rigorous view. In *Hammerty v. Standard Theater Co.*,[15] the corporation had leased certain land with the privilege of purchasing the fee. The corporation assigned the privilege to one of the directors, who in turn purchased the fee. The purchase was held valid where it appeared that the corporation had neither the

[11] *Ibid.* "Uncompromising rigidity has been the attitude of the courts of equity when petitioned to undermine the rules of undivided loyalty by the 'disintegrating erosion of particular exceptions." Note: This rule applies only to solvent corporations.

[12] Alger v. Brighter Days Mining Corporation, 63 Ariz. 135, 160 P. 2d 346 (1945); Hannerty v. Standard Theater Co. 109 Mo. 297, 19 S.W 82 (1892); Beaumont v. Folsom, 136 Neb. 235, 285 N.W 547 (1945).

[13] DuPont v. DuPont, 256 Fed. 129 (C.C.A. 4th 1919).

[14] Zeckendorf v. Stienfield, 12 Ariz. 245, 100 P. 784 (1909).

[15] 109 Mo. 297, 19 S.W 82 (1892).

credit nor money necessary for making the purchase. In *Green* v. *Hall*,[16] the corporation held a lease conditioned to become void if a paying quarry was not established on the land in two years. The corporation failed to develop the quarry and the defendant director, upon forfeiture of the lease, took a new lease for himself. It was held that the director took the lease free from any interest of the corporation since failure to develop the quarry was not due to the failure of the director, but only to the corporation's inability to finance it.

In a recent Nebraska case,[17] tax sale certificates were issued against the corporation's property. There was also a mortgage outstanding against the property. The mortgagee received a decree for $26,000.00 and offered to exchange his decree for stock of a certain company. This stock could be purchased on the market for $15,000.00. The corporation was unable to purchase the stock. The directors endeavored to get the shareholders to contribute a sufficient amount to redeem the mortgage and tax sale certificates but all refused. The directors purchased the tax sale certificates and the stock. They exchanged the stock for an assignment of the mortgagee's decree and instituted forclosure proceedings and bid in the property. A deed was issued to the directors and they formed a new corporation, which was operated at a considerable profit. Stockholders of the old corporation brought an action to have the conveyance declared void. In holding the conveyance valid, the court indicated that dealings with corporate property would be given the most careful scrutiny. Nevertheless, the court said;

> "This does not mean, however, that a court of equity will avoid every transaction involving corporate property to which a director is a party. A director is not prohibited from purchasing, in good faith, an outstanding lien on corporate property with the knowledge of every stockholders (sic), to protect his own investment, where the corporation is without financial ability to take up the lien, and the other stockholders have refused to join in a contribution for this purpose."[18]

A case similar to the *Nebraska* case was decided in Arizona.[19] In that case Samoa Gold Mines Corporation was in the hands of the Commercial Co. Commercial gave Samoa an option to pay a certain amount each month and operate the mines. Samoa did not have funds to take up the option or continue the development of the mines. The defendant directors purchased the property at a judicial sale and organized a new corporation. It was held that Samoa had no interest actual or in expectancy at the time of the purchase by the directors. As in the previous case, the directors endeavored to get the stockholders to join in a contribution to prevent the sale. In a further display of good faith, the stockholders were extended an opportunity to participate in the corporation, but they refused.

In the light of the forgoing cases, it is apparent that the application of the rule of *uncompromising rigidity* has been considered too harsh. This rule is based upon public policy and not upon the narrow ground of resulting injury to the corporation. Public policy is thought to be best served when temptation is re-

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[16] 228 S.W 183 (Texas 1921).
[17] Beaumont v. Folsom, 136 Neb. 235, 285 N.W 547 (1939).
[18] *Id.* at 285 N.W 550.
[19] Alger v. Brighter Days Mining Corporation, 63 Ariz. 135, 160 P. 2d 346 (1945).

moved and the possibility of profit from a beach of the fiduciary relationship is extinguished. It has been well stated, however, that the true basis is to be found in the unfairness of a fiduciary taking advantage of any opportunity when the interests of the corporation justly call for protection.[20] This calls for an application of ethical standards of what is fair and equitable to a particular set of facts.

In the final analysis any rule adopted should accomplish two things. In the first place it should encourage, not impede, legitimate business transactions, and in the second place it should accomplish justice to all parties. The rule in the *Deutsch* case would satisfy the loyalty requirement, but in many instances it may well be injurious to business. For example, if Deutsch had been precluded from purchasing the stock at the outset, Acoustic would have failed immediately. Although Acoustic later became bankrupt, there was a good chance of its survival. The liberal rule would allow directors, on proper occasions, to assist the corporation by taking over necessary contracts or transactions when the corporation was not financially able to do so. The same high degree of loyalty could be required and enforced through the exaction by the courts of clear and convincing proof of real financial inability. For these reasons it is submitted that financial inability should be allowed as a defense when clearly established, since it is the more practicable and equitable rule.

E. W RIVERS

HALE v. HALE – KENTUCKY'S RECOGNITION OF THE TENTATIVE TRUST

Where one deposits money in the bank in a savings account indicating an intention to be trustee of the money for another, the courts in a number of jurisdictions will find that he has created a "tentative trust" which may be revoked completely or which may be revoked in part by withdrawals during his lifetime. Therefore the trust is not final or complete except as to the amount in the account at the depositor s death. It is clear that such a trust is not testamentary and may be created without the formalities of execution required by the Statute of Wills. The Court of Appeals of Kentucky recently recognized and applied the tentative trust doctrine for the first time in *Hale* v. *Hale*.[1] It is the purpose of this comment to direct attention to this case, to describe the essential characteristics of the doctrine and to suggest some of the more important implications in its recognition by the Kentucky Court.

In the principal case, Hale deposited in a savings account a sum of money to his own credit, and a bank employee, on Hale s orders, made an endorsement on the bank deposit record, which Hale signed, directing that the money be paid to Hale s named children if anything happened to him. There was uncontradicted testimony to the effect that Hale told others of the deposit and its purpose. About a year after the deposit Hale died, but on the day before his death he issued to his daughter a check against the account for the dual purpose of paying his expenses and making a gift to her of the balance of the check, if any. Although it was conceded that the memorandum on the bank record did not qualiafy as a will

[20] Durfee v. Durfee & Canning, Inc., 323 Mass. 187, — 80 N.E. 2d 522, 529 (1948).

[1] 313 Ky. 344, 231 S.W 2d 2 (1950).