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## Chapter 5: Corporations and Partnerships

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C H A P T E R 5

Corporations and Partnerships

CORNELIUS J. MOYNIHAN

§5.1. **Corporate opportunity doctrine.** In the brief span of a single SURVEY year startling developments and new departures are hardly to be expected in the law of business associations. More likely, the decisions will reflect a refinement of doctrine and the application of established principles to new fact situations. But growth and expansion of particular rules of law can be observed within the confines of specific cases. We may take as an example the doctrine of corporate opportunity. This doctrine, derived from the fiduciary nature of a director's duty to his corporation, forbids a director to take for his own benefit a business opportunity, a contract or a property interest that in fairness should be made available to the corporation. The doctrine is designed to insure the integrity of corporate management and to resolve a conflict of interest in favor of the corporation. Nevertheless, in a case decided in 1941, *Lincoln Stores v. Grant*,<sup>1</sup> the Supreme Judicial Court not only refused to apply the doctrine to a fact situation that strongly justified its invocation but cautiously stated that

the legal restrictions that rest upon officers in their acquisitions are generally limited to property in which the corporation has an interest already existing, or in which it has an expectancy growing out of an existing right, or to cases where the officers' interference will, in some degree, prevent or hinder the corporation in effecting the purposes of its creation.<sup>2</sup>

This narrow statement of the doctrine was later repudiated in *Durfee v. Durfee & Canning, Inc.*,<sup>3</sup> and "the true basis of the governing doctrine" was held to rest "fundamentally on the unfairness in the particular circumstances of a director, whose relation to the corpo-

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§5.1. 1 309 Mass. 417, 34 N.E.2d 704 (1941).

2 309 Mass. at 421, 34 N.E.2d at 707.

3 323 Mass. 187, 199, 80 N.E.2d 522, 529 (1948).

ration is fiduciary 'taking advantage of an opportunity (for his personal profit) when the interest of the corporation justly calls for protection.'"<sup>4</sup> This broad statement of the rule has since been followed, and the *Durfee* case has become a precedent for increasingly frequent applications of the doctrine. In the 1962 SURVEY year, two cases, one federal and one state, dealt with the doctrine.

In *W. H. Elliott & Sons Co. v. Gotthardt*<sup>5</sup> a corporate creditor complained of a transaction in which a director allegedly diverted a business opportunity from his corporation to another corporation in breach of his fiduciary duty. According to the allegations of the complaint, two of the directors of the debtor corporation caused a new corporation to be organized for the purpose of acquiring land and buildings adjacent to the plant of the debtor corporation. A portion of this land was afterward leased to the debtor corporation, which needed additional warehouse space. In granting a motion for summary judgment the trial judge had ruled that "under the law of Massachusetts the acquisition of property, to constitute an interference with a corporate opportunity, 'must be not only within the corporate purpose but also highly desirable if not absolutely necessary.'" Oddly enough, *Durfee v. Durfee & Canning, Inc.* was cited as authority for this proposition. In reversing, the Court of Appeals for the First Circuit correctly pointed out that the rule laid down in *Durfee* was not so narrowly limited. It further ruled that the asserted financial inability of the corporation to acquire the property did not relieve the directors of their duty to the corporation.

In *Wilson v. Jennings*<sup>6</sup> shareholders complained in a derivative suit that a manufacturing contract which the controlling director caused the corporation to enter into with a second corporation in which such director became a 50 percent shareholder as well as director violated the fiduciary duties owed by the director. The Supreme Judicial Court upheld a decree declaring the contract void and imposing a constructive trust on the shares acquired by the defendant director in the second corporation. The basis for the relief granted was the taking by the director for his own benefit of an advantageous opportunity which belonged to the corporation. Again the *Durfee* case was relied on as authority for the conclusion reached.

**§5.2. Derivative suits: Joinder of corporate and individual causes of action.** In a shareholder's derivative suit the plaintiff is necessarily asserting a claim belonging to the corporation. In substance the corporation is the plaintiff, and the shareholder merely sets the judicial machinery in motion to enforce a corporate cause of action. If the plaintiff shareholder combines in a single suit both a corporate and an individual cause of action, the two causes of action are in legal theory unconnected and the objection may be made that the bill is

<sup>4</sup> The Court's quotation is from Ballantine, Corporations 204-205 (rev. ed. 1946).

<sup>5</sup> 305 F.2d 544 (1st Cir. 1962).

<sup>6</sup> 1962 Mass. Adv. Sh. 1107, 184 N.E.2d 642.

multifarious.<sup>1</sup> The claim of multifariousness was urged as a ground of demurrer in *Wilson v. Jennings*<sup>2</sup> to the bill in the derivative suit in that case. In addition to allegations of breach of fiduciary duty by the individual defendants as directors (consisting of obtaining an unfair long-term employment contract from the corporation and the seizure for themselves of a corporate opportunity) the bill alleged that two of the defendant directors caused additional shares to be issued to themselves at a price below the fair market value for the purpose of wresting corporate control from the plaintiffs. To the extent that the issuance prices of these shares were below their actual value, there was an injury to the corporation. But if the additional shares were issued for the purpose of diluting the plaintiffs' voting power, it was a private wrong to the plaintiffs.<sup>3</sup> In rejecting the argument of multifariousness, the Court stated that the various issues were closely interrelated and based upon the same transactions. This represents a realistic approach to the issue of multifariousness.<sup>4</sup>

The litigation in *Wilson v. Jennings* in fact involved two suits: one a derivative suit brought in Suffolk County, the other an individual suit by the same shareholders brought in Middlesex County. The directors of the corporation were defendants in both suits. Both cases were consolidated for trial, and the appeals were heard on a consolidated record. Some, although not all, of the factual issues were common to both cases but the legal principles underlying the plaintiffs' right to relief in each case were different. There is a risk in such a situation of confusion of issues, and such confusion did occur. The trial judge's findings of fact failed to distinguish between the duties owed by directors to the corporation and those owed to the plaintiffs individually by reason of a pre-incorporation contract. As a consequence, the final decree in the derivative suit went beyond the scope of the pleadings in that case.<sup>5</sup> Specifically, the decree adjudged that

§5.2. <sup>1</sup> In *Whitney v. Whitney*, 296 Mass. 13, 4 N.E.2d 438 (1936), the bill, brought by a shareholder against the majority shareholder and the corporation, alleged that the individual defendant had misappropriated corporate assets and also that he had wrongfully caused the issuance of additional shares to himself. A demurrer to the bill on the ground of multifariousness was sustained. The Court was content to state: "Joining these two unconnected causes of suit in one bill made it multifarious." The improper issuance of shares to the individual defendant was held to be a wrong to the plaintiff and not to the corporation. Cf. *Andersen v. Albert & J. M. Anderson Manufacturing Co.*, 325 Mass. 343, 90 N.E.2d 541 (1950).

<sup>2</sup> 1962 Mass. Adv. Sh. 1107, 184 N.E.2d 642.

<sup>3</sup> *L. E. Fosgate Co. v. Boston Market Terminal Co.*, 275 Mass. 99, 175 N.E. 86 (1931); *Bennett v. Breuil Petroleum Corp.*, 99 A.2d 236 (Del. Ch. 1953).

<sup>4</sup> The criterion for determining whether a bill is multifarious was well stated by Lummus, J., in *Peterson v. Hopson*, 306 Mass. 597, 610, 29 N.E.2d 140, 148-149 (1940): "The objection that a bill is multifarious is not one to be determined according to formal or crystallized rules. It is addressed to the practical wisdom of the court, which must consider whether the bill raises issues too diverse and complex to be dealt with in a single proceeding efficiently and with fairness to the defendants."

<sup>5</sup> Since the allegations of the bill in each suit are not set forth in the Court's opinion, the discrepancy between bill and decree appears only from an examination of the record. See Record, pp. 2-13, 406-408.

the employment contract obtained by the principal defendant, Jennings, from the corporation was void and of no effect. On appeal this portion of the decree was affirmed on the ground that it violated the pre-incorporation agreement between Jennings and the plaintiff. Yet the bill of complaint in the derivative suit did not, and perhaps properly could not, allege a pre-incorporation contract between the promoters.

**§5.3. Derivative suits: Allowance of counsel fees.** It is well settled that the successful plaintiff in a derivative suit is normally entitled to an allowance for counsel fees and expenses to be paid by the corporation out of the funds recovered by it from the defendant. The basis for this allowance has been said to be "that an expense incurred by one, resulting in the creation of a fund for the general benefit of many other persons, ought not to be borne entirely by the one whose action has resulted in the realization of such a fund, and that it is equitable that a part of the expense should be paid out of the fund."<sup>1</sup> Even if no fund is recovered out of which payment may be made, reimbursement is allowed by most courts when the litigation has benefited the corporation, as by the setting aside of an unfavorable contract.<sup>2</sup>

The award of counsel fees in *Wilson v. Jennings*<sup>3</sup> was unusual in two respects. The decree in the derivative suit, instead of ordering an allowance of counsel fees to the plaintiff to be paid by the corporation, ordered the principal defendant, Jennings, and his wife (also a defendant) to pay to the corporation \$5000 "for costs and expenses and counsel fees incurred by Polytop Corporation." On appeal this portion of the decree was, in substance, affirmed. There would seem to be no precedent for such a decree. The cases cited in support<sup>4</sup> merely followed the usual practice of granting to the plaintiff an allowance for counsel fees to be paid out of the fund recovered by the corporation. But the decree in *Wilson* compelled the individual defendants to pay the counsel fees of the corporation, and presumably of the plaintiffs, thus departing from the basic rule that each party to litigation must bear his own expense for counsel fees.

In the second suit involved in *Wilson*, the decree ordered Jennings and his wife to pay \$1000 to the corporation for its counsel fees and expenses. This decree was also upheld in substance on appeal. Again, there would seem to be no precedent for such a decree. In the second suit the plaintiffs were suing on an individual cause of suit to enforce their personal rights. Only the normal costs as between party and party but not counsel fees are allowable in this type of litigation.<sup>5</sup>

§5.3. <sup>1</sup> *Shaw v. Harding*, 306 Mass. 441, 450, 28 N.E.2d 469, 474 (1940).

<sup>2</sup> See, e.g., *Schechtman v. Wolfson*, 244 F.2d 537 (2d Cir. 1957); *Richman v. DeVal Aerodynamics, Inc.*, 185 A.2d 884 (Del. Ch. 1962). Cf. *Shaw v. Harding*, 306 Mass. 441, 28 N.E.2d 469 (1940).

<sup>3</sup> 1962 Mass. Adv. Sh. 1107, 184 N.E.2d 642.

<sup>4</sup> *Sagalyn v. Meekins, Packard & Wheat Inc.*, 290 Mass. 434, 195 N.E. 769 (1935); *Samia v. Central Oil Co. of Worcester*, 339 Mass. 101, 158 N.E.2d 469 (1959), noted in 1959 Ann. Surv. Mass. Law §§5.3, 5.4, 5.5.

<sup>5</sup> *Commissioner of Insurance v. Massachusetts Accident Co.*, 318 Mass. 238, 61 N.E.2d 137 (1945); *Sarner v. Sarner*, 38 N.J. 463, 185 A.2d 851 (1962).

§5.4. **Close corporations: Pre-incorporation shareholder agreements.** Persons intending to organize a close corporation<sup>1</sup> often desire that their interests as participants in the enterprise be governed other than by the corporate norms regulating the rights of shareholders. What they contemplate may be loosely described as an incorporated partnership—a corporate entity which shields the shareholders from liability for debts of the enterprise with the rights and obligations of the members inter se being subject to the strict fiduciary relationship of partners. In some but not all jurisdictions a pre-incorporation contract among the organizers specifying their rights as shareholders is held to survive the coming into existence of the corporation and to determine the internal relations of the shareholders. In those jurisdictions which recognize such an agreement as continuing to control the relations of the parties, the pre-incorporation contract becomes an effective device to prevent a squeeze-out of a minority shareholder.<sup>2</sup> But even a majority shareholder may find that this type of arrangement affords him protection when he has unwarily permitted the minority to gain control of the board of directors.

In *Wilson v. Jennings*<sup>3</sup> the dominant position of the majority shareholders was threatened when the minority shareholder, who controlled the board of directors, caused additional shares of stock to be issued to himself. A pre-incorporation contract among the parties enabled the majority to preserve the balance of power. The corporation was organized by the two plaintiffs and the defendant Jennings. Ten shares of stock were issued to each of the organizers. The three parties, it was found by the trial judge, “agreed to be equal one-third owners of . . . Polytop . . . with the stock ownership to be divided equally.” Subsequently, the defendant Jennings negotiated a sixteen-year employment contract with the corporation at a specified salary plus commissions. Under the terms of this contract Jennings had the privilege of converting any indebtedness of the corporation to him into voting stock at the rate of one share for each \$1000 of debt. Jennings later caused an additional thirty shares of stock to be issued to himself by exercising the conversion privilege pursuant to the contract. This employment contract was not disclosed to the plaintiffs until after the defendant had converted his debt into stock.

The Court struck down the employment contract on the ground that it violated the pre-incorporation agreement between the incorpo-

§5.4. <sup>1</sup> The term “close corporation” has no precise definition. It is used with reference to a corporation having a small number of stockholders, the shares of the corporation not being registered on a stock exchange or regularly traded in an over-the-counter market; commonly, the shareholders, or a majority of them, are corporate directors and officers. The term has no reference to the financial size of the corporation. See 1 O’Neal, *Close Corporations* §§1.02, 1.07 (1958).

<sup>2</sup> Various devices may be used by the control group to squeeze out a minority: merger, consolidation, sale of assets, issuance of additional shares, withholding of dividends, or denial of corporate office and employment. See Note, *Freezing Out Minority Shareholders*, 74 Harv. L. Rev. 1630 (1961).

<sup>3</sup> 1962 Mass. Adv. Sh. 1107, 184 N.E.2d 642.

rators. As to this agreement the Court held that the trial judge could find on the evidence that the parties "on an informal and somewhat ambiguous basis had entered into what was essentially a joint venture in corporate form to exploit the plastic top invention"; that there was a mutual understanding that the parties would keep one another informed of their activities; that the three-way equal division of stock was to be permanent; and that the relationship was to be one of trust and confidence.<sup>4</sup> The employment contract, the Court concluded, was executed in breach of the fiduciary duty of disclosure owed by the defendant Jennings, and the provision in the contract for the conversion of debt into stock violated the understanding that there would be an equal division of stock in the corporation.

Where the parties, prior to incorporation, have been carrying on a joint venture and then decide to incorporate the undertaking, their understanding that their relations should continue to be governed by the rules controlling joint ventures should be given effect.<sup>5</sup> So also, where the organizers of a corporation have clearly expressed their intention in a pre-incorporation agreement that their internal relations shall be regulated by the agreement rather than by corporate norms, the contract should be treated as valid.<sup>6</sup> It may be doubted, however, whether an informal and ambiguous understanding between the participants justifies a deviation from the corporate norms regulating the rights of shareholders.

§5.5. **Derivative suits: Form of demand on shareholders.** It is the established rule in many jurisdictions, including Massachusetts, that before commencing a derivative suit, the plaintiff shareholder must first make a demand on the board of directors to take action with reference to the matters complained of,<sup>1</sup> and if such demand is refused, make application to the body of shareholders except when a majority of the directors and of the shareholders are themselves the wrongdoers or acting in collusion with them.<sup>2</sup> Since this requirement of exhaustion of remedies within the corporation is a condition precedent to the plaintiff's right to maintain the suit, he must in his pleading

<sup>4</sup> 1962 Mass. Adv. Sh. at 1111-1112, 184 N.E.2d at 646. It is not clear that the trial judge did in fact make such findings. His "Findings of Fact, Rulings of Law and Order for Decree" were a confusing mixture of ambiguous factual findings and erroneous conclusions of law. See Record, pp. 401-405.

<sup>5</sup> *Wabash Railroad Co. v. American Refrigerator Transit Co.*, 7 F.2d 335 (8th Cir. 1925); *Elsbach v. Mulligan*, 58 Cal. App. 2d 354, 136 P.2d 651 (1943); *Latimer v. Piper*, 261 Mich. 123, 246 N.W. 65 (1933); *Mendelsohn v. Leather Manufacturing Corp.*, 326 Mass. 226, 93 N.E.2d 537 (1950). *Contra*: *Jackson v. Hooper*, 76 N.J. Eq. 592, 75 Atl. 568 (1910); *Weisman v. Awnair Corp. of America*, 3 N.Y.2d 444, 144 N.E.2d 415 (1957).

<sup>6</sup> *Moss v. Waytz*, 4 Ill. App. 2d 296, 124 N.E.2d 91 (1955); *DeBoy v. Harris*, 207 Md. 212, 113 A.2d 903 (1955); *Sher v. Sandler*, 325 Mass. 348, 90 N.E.2d 536 (1950).

§5.5. <sup>1</sup> *Bartlett v. New York, New Haven & Hartford R.R. Co.*, 221 Mass. 530, 109 N.E. 452 (1915); *Brewer v. Boston Theatre*, 104 Mass. 378 (1870).

<sup>2</sup> *S. Solomont & Sons Trust, Inc. v. New England Theatres Operating Corp.*, 326 Mass. 99, 93 N.E.2d 241 (1950); *Pomerantz v. Clark*, 101 F. Supp. 341 (D. Mass. 1951).

specify what efforts he has made to obtain action by the directors and stockholders or allege facts showing an adequate reason for his failure to do so.<sup>3</sup>

The demand on the board of directors will normally consist of a request that the board institute proceedings to enforce the corporation's cause of action against the wrongdoers.<sup>4</sup> The nature of the demand that must be made on the shareholders has received little attention from the courts.<sup>5</sup> This question was presented in *Halprin v. Babbitt*,<sup>6</sup> and the court held that the form of the demand should be a request that the shareholders cause proceedings to be instituted against the wrongdoers. The court stated that there are two purposes for this: "The first is to permit the majority to take some sort of affirmative action itself. The second is to permit the majority to decide . . . that no action be taken by anybody."<sup>7</sup> If the majority fails to act at all, the court held, the minority shareholder may proceed with a derivative suit. No express authorization from the majority to institute the suit is necessary.

**§5.6. Corporations: Remedies of corporate creditors against directors.** When directors of a corporation commit a breach of their fiduciary duty to the corporation it is clear that they can be held accountable to the corporation either in a direct proceeding by the corporation itself or in a shareholder's derivative suit. In some situations the breach of duty by the directors may also cause indirectly an injury to corporate creditors. The remedies available to the creditors in such circumstances are not wholly clear. This problem arose, but was not decided, in *W. H. Elliott & Sons Co. v. Gotthardt*.<sup>1</sup>

<sup>3</sup> In *Pomerantz v. Clark*, 101 F. Supp. at 344, it was said by Wyzanski, J.: "The fundamental basis of the rule is the Massachusetts view that neither an individual member nor a court is usually best fitted to determine whether it is to the interest of a corporation publicly to enforce corporate claims even if those claims are founded on plainly unlawful conduct participated in by corporate officers or directors. A disinterested internal organ of the corporation has the advantage of familiarity with the enterprise, with those who have conducted it and with the record of success or failure." An allegation in the complaint that the majority shareholders have "refused" to institute an action is not, without more, sufficient. "The fact that the majority had 'refused' to sue may merely mean a passive failure to act. It does not import receipt and rejection of a demand, or constitute an excuse for failure to make one." *Halprin v. Babbitt*, 303 F.2d 138, 140 (1st Cir. 1962).

<sup>4</sup> *Bartlett v. New York, New Haven & Hartford R.R. Co.*, 221 Mass. 530, 109 N.E. 452 (1915).

<sup>5</sup> See Note, Demand on Directors and Shareholders as a Prerequisite to a Derivative Suit, 73 Harv. L. Rev. 746, 749-750 (1960).

<sup>6</sup> 303 F.2d 138, 141 (1st Cir. 1962). The court also stated that a demand by the plaintiff shareholder merely requesting permission to proceed by himself at his own expense would not be sufficient. As to the "affirmative action" available to the shareholders as a body, conceivably the shareholders could instruct the board of directors (if there is a disinterested majority) to sue the wrongdoers, or remove the wrongdoing directors for cause and elect their successors, or decide to bring a derivative suit in behalf of the majority.

<sup>7</sup> 303 F.2d at 141.

§5.6. 1 305 F.2d 544 (1st Cir. 1962).



In that case the plaintiff was a judgment creditor of King Company, a Massachusetts corporation. His complaint alleged that during the pendency of the litigation which resulted in the judgment for the plaintiff the assets of King Company available for satisfaction of the judgment were substantially reduced by the conduct of the directors of King Company; that this conduct consisted of the diversion of a business opportunity from the King Company to a new corporation organized by the directors, and of the transfer of assets of King Company for the purpose of putting them beyond the reach of creditors. The relief requested by the plaintiff was that the directors should be required to account to the plaintiff for the alleged diversion of property, business opportunity and profits, and to the extent that the individual defendants had prejudiced the plaintiff's ability to satisfy its judgment against King Company they should be held "directly liable to this plaintiff for the damage thus resulting." The plaintiff demanded judgment for monetary damages against King Company, its directors and officers. The trial judge granted summary judgment in favor of two of the individual defendants. The Court of Appeals affirmed the judgment as to the defendant Frothingham and reversed as to the defendant Gotthardt. Frothingham was sales manager of a division of the corporation, and clerk of the corporation. He was let out on the ground that:

The Massachusetts cases with regard to the liability of corporate directors and officers to creditors for breach of their fiduciary obligation to creditors, or to the corporation itself, make it clear that the court has imposed liability only on corporate directors and major corporate officers.<sup>2</sup>

Frothingham had not been active in or consulted on corporate policy matters and as clerk was not liable for any breach of duty. But the defendant Gotthardt was vice-president and a director of the corporation and concerning him it was held that the record presented a fact question as to whether he, as a director, had participated in usurping a corporate opportunity "for which he may be responsible to the creditors of King Company."<sup>3</sup> It was further held that it was a question of fact whether the transfer of assets of King Company to a newly organized corporation in which Gotthardt and Frothingham acquired a 40 percent stock interest did involve a violation of Gotthardt's fiduciary duties as director.

The plaintiff seems to have pitched its case on the theory that misconduct on the part of corporate directors and officers gives rise to a direct liability to corporate creditors. There is little in the cases to support this view. The duties imposed on directors are duties owing to the corporation itself. If a director is guilty of a breach of the duty of care or of loyalty to the corporation, there is a corporate cause of action for such breach and this cause of action is a corporate asset

<sup>2</sup> 305 F.2d at 545.

<sup>3</sup> 305 F.2d at 547.

available to a corporate creditor by a bill to reach and apply. Normally, the creditor has no direct cause of action against the director.<sup>4</sup> There would seem to be little, if any, justification for imposing on a director a fiduciary duty with respect to corporate creditors. Such a concept imports a relation of trust and confidence involving a duty of loyalty and a high degree of good faith. There is to be found in some of the cases the statement that a director is "to some extent" a trustee of the corporate property for creditors, but these cases involve an improper distribution of assets to shareholders<sup>5</sup> or the obtaining of a preference by the director when the corporation is, or is about to become, insolvent.<sup>6</sup> A statement of this nature really means that a director will not be allowed to deal unfairly with the corporate property at the expense of creditors.

In *Elliott* the issue as to the appropriate relief available to the plaintiff was not before the Court of Appeals. Assuming that the defendant Gotthardt participated in the usurpation of a corporate opportunity and the improper diversion of corporate assets, the plaintiff judgment creditor could reach and apply the debtor corporation's cause of action against that director, and could also have set aside any fraudulent conveyance of corporate assets. Since the pleadings and affidavits raised questions of fact as to Gotthardt's breach of duty to the corporation, the latter's motion for summary judgment was properly denied.

**§5.7. Limited partnership: Right of limited partner to rescind for fraud.** When a partner in an ordinary partnership has been induced to become a member of the firm by reason of fraud or misrepresentation by his associates, his right to rescind the contract of partnership and to recover his contribution to the capital is subject to the prior right of firm creditors to payment of the obligations owing to them. The express provisions of Section 39 of the Uniform Partnership Act<sup>1</sup> to this effect are declaratory of the common law rule.<sup>2</sup> On the question of the right of a limited partner to rescind for fraud and to recapture his capital contribution after the insolvency of the limited partnership, the answer is none too clear. The Uniform Limited Partnership Act<sup>3</sup> has no provision parallel to Section 39 of the Uniform Partnership Act and there seem to have been no cases on the point.

This problem arose in *Securities and Exchange Commission v.*

<sup>4</sup> *Young v. Haviland*, 215 Mass. 120, 102 N.E. 338 (1913); *Allen v. Cochran*, 160 La. 425, 107 So. 292 (1926). See Ballantine, *Corporations* 185-186 (rev. ed. 1946). Statutes are to be found in many states imposing liability on directors to creditors for specific acts. See, e.g., G.L., c. 156, §36 (illegal stock issuance, executing false reports of condition); §37 (illegal dividends and loans to directors or shareholders).

<sup>5</sup> *Seder v. Gibbs*, 333 Mass. 445, 131 N.E.2d 376 (1956); *Burke v. Marlboro Awning Co.*, 330 Mass. 294, 113 N.E.2d 222 (1953).

<sup>6</sup> *Albert Richards Co. v. The Mayfair, Inc.*, 287 Mass. 280, 191 N.E. 430 (1934).

§5.7. 1 G.L., c. 108A.

<sup>2</sup> *Grossman v. Lewis*, 226 Mass. 163, 115 N.E. 236 (1917).

<sup>3</sup> G.L., c. 109.

*duPont, Homsey & Co.*,<sup>4</sup> and it was held that the defrauded limited partner's right to recover his capital contribution out of the assets of the insolvent limited partnership was subject to the prior rights of third persons to have their claims satisfied. The court reached this result by applying Section 39 of the Uniform Partnership Act and invoked the language of Section 6(2) of the Uniform Limited Partnership Act in support.<sup>5</sup> The latter section recites that the Uniform Partnership Act "shall apply to limited partnerships except in so far as the statutes relating to such partnerships are inconsistent herewith." It is open to some doubt, however, whether the right of a limited partner to rescind the limited partnership contract for fraud is subject to the same statutory provisions as those governing a general partner. Unfortunately, the adoption of the term "limited partner" has helped to create the impression that a limited partner is only a special type of partner.<sup>6</sup> Actually, he is a member of the association who has made an investment in the enterprise.<sup>7</sup> His status is more analogous to that of a shareholder in a corporation than that of a general partner.

Nevertheless, the conclusion reached by the court would seem to be sound. Normally, the owners of an enterprise will not be allowed to compete with creditors in the distribution of the assets of the business. And, despite some diversity of opinion, by the weight of authority a shareholder in a corporation will not be allowed to rescind his stock subscription after corporate insolvency against subsequent creditors of the corporation.<sup>8</sup>

<sup>4</sup> 204 F. Supp. 944 (D. Mass. 1962).

<sup>5</sup> G.L., c. 108A, §6(2).

<sup>6</sup> The Commissioners' Note to Section 1 of the Uniform Limited Partnership Act states: "In the draft [of the act] the person who contributes the capital, though in accordance with custom called a limited partner, is not in any sense a partner. He is, however, a member of the association." 8 U.L.A. 4 (1922).

<sup>7</sup> "A limited partnership is simply a matter of investment." *Plasteel Products Corp. v. Eisenberg*, 170 F. Supp. 100, 102 (D. Mass. 1959), *aff'd sub nom. Plasteel Products Corp. v. Helman*, 271 F.2d 354 (1st Cir. 1959), noted in 1960 Ann. Surv. Mass. Law §5.6.

<sup>8</sup> See, e.g., *Commissioner of Banks v. Cosmopolitan Trust Co.*, 253 Mass. 205, 148 N.E. 609 (1925); *Burningham v. Burke*, 67 Utah 90, 245 Pac. 977, 46 A.L.R. 666 (1926); *Ballantine, Corporations* 785-788 (rev. ed. 1946).