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# Corporations—Suits by Individual Creditors Under Section 59 of Stock Corporation Law

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case the bribery alleged was found to be of a serious nature and also played a central role in the performance of the contract.

This rule, as formulated by the Court of Appeals, while supported by public policy and the majority of other states, is of such a nebulous character that increased litigation in this area would seem probable. Questions such as how "serious" or how "illegal" need the acts be to deny recovery on a valid contract need be answered in each case. Also the question as to when the illegal act is "direct" or only peripheral need be decided in view of the different facts of each case. Perhaps the size of the windfall resulting to the defendant will have some bearing on whether the illegal act is serious or direct enough to vitiate the contract.

## CORPORATIONS

### SUITS BY INDIVIDUAL CREDITORS UNDER SECTION 59 OF STOCK CORPORATION LAW

The principal issue raised in *American Broadcasting-Paramount Theater Inc. v. Frye*[1], was whether under New York Stock Corporation Law Section 59[2], a single creditor was a real party in interest and could bring the action in his own name or whether a class action had to be maintained.

The Appellate Division affirmed the judgment of the trial court directing a verdict in favor of the plaintiff,[3] a creditor of the corporation whose officers and directors, defendants here, had made loans to one of them in his capacity as a stockholder in violation of Section 59.

In construing Section 59, the courts have held that the liability is in the nature of a penalty,[4] and that an individual creditor can enforce it in his own name for his own benefit.[5]

The defendants, relying on *National Bank of Auburn v. Dillingham*,[6]

1. 8 N.Y.2d 232, 203 N.Y.S.2d 850 (1960).
2. Liability of directors for loans to stockholders. No loans of moneys shall be made by any stock corporation, except a moneyed corporation, or by any officer thereof out of its funds to any stockholder therein, nor shall any such corporation or officer discount any note or other evidence of debt, or receive the same in payment of any installment or any part thereof due or to become due on any stock in such corporation, or receive or discount any note, or other evidence of debt, to enable any stockholder to withdraw any part of the money paid in by him on his stock. In case of the violation of any provision of this section, the officers or directors making such loan, or assenting thereto, or receiving or discounting such notes or other evidences of debt, shall, jointly and severally, be personally liable to the extent of such loan and interest, for all the debts of the corporation contracted before the repayment of the sum loaned, and to the full amount of the notes or other evidences of debt so received or discounted, with interest from the time such liability accrued.
3. 9 A.D.2d 735, 193 N.Y.S.2d 441 (1st Dep't 1959).
4. Billings v. Track, 30 Hun 314 (1st Dep't 1883).
5. Wyle v. Gould, 22 Misc. 2d 935, 110 N.Y.S.2d 113 (Sup. Ct. 1951); Walters v. Spalt, 22 Misc. 2d 937, 80 N.Y.S.2d 681 (Sup. Ct. 1948).
6. 147 N.Y. 603, 42 N.E. 338 (1895).

argues that only the entire class of creditors could bring the action. In that case, which involved a statute making the responsible directors liable to *all* corporate creditors for any unsecured debts in excess of the paid in capital,[7] it was held that this was in the nature of secondary liability which could only be restored to after their remedies against the corporation had been exhausted and then only by all the creditors in a class action.

The Court of Appeals correctly distinguished the *National Bank of Auburn* case on the ground, that, ". . . [the purpose of the statute was] to cure impairments of the corporations financial worth . . . by providing a fund for reimbursement of *all* creditors."[8] In other words, making unsecured loans in excess of the paid in capital was not forbidden. On the other hand, "Section 59 of the Stock Corporation Law is clearly intended to be penal."[9] No loan is to be made in any event to stockholders, (moneyed corporations excluded) and if one is made the directors are to be penalized.

The Court of Appeals held, "Under the circumstances here, we could not, without materially distracting from the effectiveness of the remedy, decline to recognize plaintiff's right to sue.";[10] since, to do so, would require the plaintiff to locate and join all the other corporate creditors in a new action. This conclusion is in harmony with the lower court cases and is clearly calculated to carry out the intent of the Section, namely the absolute prohibition of loans to stockholders. The Court seems to have met squarely the defendant's claim that it is inequitable to allow the plaintiff exclusive recovery here by pointing out that other creditors could have intervened (Civil Practice Act Section 193-6), and that the defendant had a right to move for joinder (Rules of Civil Practice, Rule 102).

The other issue raised by the defendant had to do with the reading of the statute. The defendant urged that the first clause prohibiting the loans to stockholder was to be modified by the final phrase "to enable any stockholder to withdraw any part of the money paid in by him on his stock." Looking at the prior judicial interpretation of Section 59,[11] and the Attorney General's report on the legislative history of the Section,[12] the Court decided there was no validity to this contention, because it was clear that the legislative intent was an unconditional prohibition on moneyed loans to stockholders.

LIMITATION PERIOD APPLICABLE TO AN ACTION FOR ACCOUNTING UNDER SECTION 106 OF STOCK CORPORATION LAW

The Baldwin Trading Corporation was dissolved in 1939 for nonpayment of its franchise tax, pursuant to Section 203(a) of the Tax Law. In 1949 the

7. N.Y. Sess. Laws 1892, ch. 688, § 24.
8. Supra note 1 at 236, 203 N.Y.S.2d 853 (1960).
9. Ibid.
10. Ibid.
11. Supra notes 4 and 5.
12. 1913 Attorney General, Vol. II, 252-256.