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Corporations—Limitation Period Applicable to an Action For Accounting Under Section 106 of Stock Corporation Law

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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.

directors of the corporation distributed substantially all of the assets of the dissolved corporation. Nine-years later petitioners, representatives of deceased shareholders, brought this proceeding pursuant Section 106 of the Stock Corporation Law for an accounting. They alleged that the final distribution of the corporate assets was illegal because it was made without regard to the shareholders contributions and that shareholders received a disproportionate share of the assets.

The trial court in *In re Baldwin Trading Corporation*[13] dismissed the petition on the grounds that the proceeding was in essence "by or on behalf" of the corporation and therefore the six-year period of limitation under Section 48(8) of the New York Civil Practice Act applied. The Appellate Division reversed,[14] holding that the directors of a dissolved corporation are trustees for the purpose of liquidating the corporation, and the Statute of Limitations does not begin to run until the trust is terminated or until the trust is repudiated or denied. Therefore, the ten-year period under Section 53 of the New York Civil Practice Act is applicable. The Court of Appeals held the ten-year period applied.[15] Three of the judges held that the directors of a dissolved corporation are not trustees of an express trust. They do, however, occupy a position of fiduciary responsibility and should be held to the same standards of trust as applies to other fiduciaries. Judge Desmond in a concurring opinion agreed with the majority opinion of the Appellate Division, that directors of a dissolved corporation are in fact trustees. The three dissenting judges agreed in substance with the trial court's opinion that this was an action derivative in nature brought by or on behalf of the corporation and is limited to a six-year period under Section 48(8). Their contention being that the petitioners should not be allowed to enlarge this period by electing to proceed in equity, when an action at law has already been barred.

The various opinions present two distinct problems. First, should the directors of a dissolved corporation be considered trustees of an express trust? Second, must a proceeding brought pursuant to Section 106 of the Stock Corporation Law be necessarily one by or on behalf of the corporation or may it be one in the right of the individual shareholder? In numerous decisions directors of a dissolved corporation have been referred to as trustees. However, in most of these cases the court relied on Section 29 of the General Corporation Law which expressly referred to the directors as trustees. In 1932, Section 29 was amended and the word trustees was removed.[16] "The legislative memoranda discloses that the purpose was to prevent a change of status then existing between directors of a going corporation and those in dissolution."[17] It is clear that the directors of a functioning corporation are not trustees for

13. 2 Misc. 2d 698, 151 N.Y.S.2d 964 (Sup. Ct. 1959).
14. 8 A.D.2d 968, 190 N.Y.S.2d 949 (2d Dep't 1959).
15. 8 N.Y.2d 144, 202 N.Y.S.2d 312 (1960).
16. N.Y. Gen. Corp. Law § 29.
17. Supra note 15 at 148, 202 N.Y.S.2d 314 (1960).

the stockholders. That is, they are not trustees of an express trust as to which the statute of limitations does not run. They do, however, owe a fiduciary duty to the stockholders and courts of equity have held them to the same standards of trust as apply to other fiduciaries.[18] Therefore, to give effect to this legislative declaration the directors of a dissolved corporation should be held to the same standards.

In order to answer the second question it is necessary to characterize the cause of action as individual or derivative in nature. Section 106 of the Stock Corporation Law does not provide a period of limitation. This does not mean that no period is applicable, but that the provisions of the New York Civil Practice Act applies. Section 48(8) of the New York Civil Practice Act provides a six-year period for all actions in law or in equity, and provides that they both be treated under the same section. However, this Section does not include actions by individual shareholders brought in their own right against the directors. In the instant case the wrong alleged by the petitioners is that the shares were not ratably distributed. This is not an injury to the corporation but one to the individual shareholders. "It is obvious that wrongful acts by directors or other managers, may result in direct injuries to individual shareholder, entitling the latter to sue for their own benefit.[19] If this action is characterized as an individual cause of action, as it should be, then the appropriate period of limitations is ten years as provided by Section 53 of the New York Civil Practice Act.

The dissent argues that since there was an adequate remedy at law the choice to proceed in equity cannot enlarge the period of limitations.[20] However, it is difficult to see how the cause of action could be described as derivative in nature. The complaint does not allege a wrongful liquidation but the failure to ratably distribute. Although the complaint prayed that the relief be given to the corporation, the object of the action is to recover upon a chose in action belonging to the shareholders, not to compel the directors to perform a duty they owe to the corporation.

CREDITOR'S RIGHTS

JURISDICTIONAL DEFECT WILL NOT PREVENT APPLICATION OF REAL PROPERTY TAX LAW STATUTE OF LIMITATIONS

Once a petition for a corporate reorganization proceeding under Chapter X of the Bankruptcy Act[1] is approved, the Federal Court obtains exclusive jurisdiction over the debtor's property and no other court has the power to

18. 3 Fletcher Cyclopedia of Corporations § 1301 (1947).
19. Baker and Cary, Corporations 599 (3d ed. 1959).
20. Keys v. Leopold, 241 N.Y. 189, 149 N.E. 828 (1925).

1. 11 U.S.C. § 501 et seq.