1971

Equitable Life & Casualty Insurance Company, a Utah Corporation v. Inland Printing Company, a Utah Corporation; William A. Mulvay; D. Keith Barnes; Wendell Barnes; Harold Gailey; H. J. Barnes; Charles W. Halford; Charles Taggart aka Charles W. Taggart : Respondent's Brief

Utah Supreme Court

IN THE SUPREME COURT OF THE STATE OF UTAH

EQUITABLE LIFE & CASUALTY INSURANCE COMPANY, A Utah Corporation,
Plaintiff and Appellant,

vs.

INLAND PRINTING COMPANY, a Utah Corporation; WILLIAM A. MULVAY; D'. KEITH BARNES; HAROLD GAILEY; H. J. BARNES; CHARLES W. HALFORD; CHARLES TAGGART, aka CHARLES W. TAGGART,
Defendents-Respondents.

Case No. 12255

RESPONDENT'S BRIEF

Appeal from the Order of Dismissal of the District Court of Davis County, Utah, The Honorable Henry Ruggeri, Judge

J. Duffy Palmer
40 South 125 East
Clearfield, Utah
Attorney for Respondent
Harold Gailey

Walker E. Anderson
404 South West Temple
P'O' Box 2460
Salt Lake City, Utah
Attorney for Appelant

INDEX

CASES CITED

TEXTS

IN THE SUPREME COURT OF THE STATE OF UTAH

EQUITABLE LIFE & CASUALTY INSURANCE COMPANY, A Utah Corporation,
Plaintiff and Appellant,

vs.

INLAND PRINTING COMPANY, a Utah Corporation; WILLIAM A. MULVAY; D:.KEITH BARNES; HAROLD GAILEY; H. J. BARNES; CHARLES W. HALFORD; CHARLES TAGGART, aka CHARLES W. TAGGART,
Defendents-Respondents.

Case No. 12255

RESPONDENT'S BRIEF

NATURE OF THE CASE

This is an action filed by the plaintiff-mortgagee, of the defendant corporation against said corporation and its directors, officers and agents.

DISPOSITION BY TRIAL COURT

The trial court, after allowing plaintiff to amend its complaint twice, granted the motions to dismiss filed by the defendant, Harold Gailey, and the other officers and directors of the corporation on the grounds that the amended complaints failed to state a claim against said defendants upon which relief could be granted. The corporation defaulted.

RELIEF SOUGHT ON APPEAL

The defendant-respondent, Harold Gailey, respectfully requests this Court to affirm the lower courts Order of Dismissal with prejudice in the above entitled matter.

STATEMENT OF FACTS

The plaintiff-appeallant loaned certain monies to the defendant corporation in November of 1961. To secure the same defendant, Inland Printing Company executed and delivered to the plaintiff a first mortgage note in the amount of $41,000.00 (R.6), and as further security gave plaintiff a Real Estate Mortgage (R.7), and certain chattel mortgages (R. 12, 14, 16, 17, 19, 20). Subsequently, the defendant corporation defaulted on said indebtedness to the plaintiff and this action was commenced.

Despite the fact that defendant-respondent, Harold Gailey, never signed said note or mortgages in his own right or for that matter as an agent of the corporation (R. 6, 7, 12, 14, 16, 17, 19, 20); plaintiff, by amended complaint filed in March of 1970, joined him as defendant in his capacity as one of the directors of the corporation.

On motion of defendant, Harold Gailey, and after argument, said amended complaint was dismissed as against him by the lower court by Order signed June 4, 1970. Said Order allowing the plaintiff 20 days in which to further amend its complaint.

A second amended complaint naming the respondent herein as defendant was filed on June 10, 1970. Again on motion of respondent and after argument said second amended complaint was dismissed with prejudice by Order of the lower court dated September 2, 1970. From which Order of Dismissal this appeal was taken.

ARGUMENT

POINT I

THE DIRECTORS OF THE CORPORATION ARE NOT LIABLE TO THE PLAINTIFF AS A CREDITOR OF SAID CORPORATION AND RESPONDENT'S MOTION TO DISMISS WAS PROPERLY GRANTED.

It is well settled in law that a certain fiduciary relationship exists between the directors and officers of a corporation and the corporation or its stockholders. This relationship is often spoken of in terms of a trustee relationship. However, as this Court has recognized, directors are not trustees in the true sense.

> "Properly speaking the relationship is that of principal and agent, and the liability of the directors and other officers of the corporation for mismanagement is determined by substantially the same principles which determine the liability of any agent to his principal for failure to perform the duties he has undertaken..." *Jones Min. Co. vs. Cardiff Min. & Mill. Co. et al.*, 56 U 449, 191 Pac 426 (1920)

Although the standard of care required of a director varies somewhat from jurisdiction to jurisdiction, our courts have stated that the duty of care owed by a director to a corporation and its stockholders is that care which the ordinary prudent and diligent man would exercise under similar circumstances. *Warren vs. Robinson et al.*, 19 U 289, 57 Pac 287, (1899).

Whether described in terms of trust or agency it is clear that the officers and directors have a duty to the corporation to exercise the ordinary care and diligence of a

prudent man in the conduct of corporate affairs. If tha duty is breached, then as in other matters, the corporatio and its stockholders have a right of action against said directors for any damages suffered as a result thereof.

It should be noted however that to show a breach o duty is not in itself enough to justify a recovery. In orde for a cause of action to exist in behalf of the corporatio there must be some causal connection between the defend ants negligent breach of duty and the loss of the plaintiff.

Assuming such negligence or other breach of duty on th part of directors as would render them personally liable a the suit of the corporation or anyone suing in its right, the critical question here before the court is whether a creditor can 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.

By the great weight of authority the general rule in this regard is that a creditor of a corporation may not maintain a personal action against the officers or directors of a corporation, who, have by their mismanagement or negli gence, committed a wrong against the corporation to the consequent damage of the creditor. *Clark vs. Lawrence* (Mass), Brunner, Col. Cas. 637, Fed Cas. No 2, 827(1856); *Hart vs. Evanson,* 14 N. D. 570, 105 N.W. 942 (1895); *U.S.F. & G. Co. vs. Corning State Bank,* 154 Iowa 588, 45 L.R.A. (NS) 421 (1912) 50 ALR 462.

Some of the rationale for such a rule was indicated in the *Clark Case, supra,* as follows: (1) that the directors are agents of the corporation, and not the creditors, and therefore there is no privity between them; (2) an injury done to the capital of the corporation, is not, in contemp lation of law, an injury to each of its creditors; and

(3) if one creditor may have such an action, every creditor may; and thus a vast multiplicity of suits may be brought for one wrong.

Although the general rule is to the effect that creditors of a corporation may not sue directors or officers for negligence or mismanagement, a minority of jurisdictions have allowed such suits in the limited circumstances where these is evidence of fraud and deceit in the form of self dealing between the directors and the corporation or its stockholders.

W. P. Mercantile Co. vs. Mt. Pleasant Equitable Co-operative Inst., 12 U 213, 42 Pac 869 (1894); *Callahan vs. Pioneer Nurseries*, 49 U 541, 164 Pac 878 (1917); *Sweeney vs. Happy Homes Inc.*, 18 U2d 113, 417 P2d 126 (1966).

In the *Noble Case, supra,* the directors were also creditors of the corporation and perferred themselves over other creditors whoes claims were equally meritorious. The corporation in the *Callahan Case, supra,* which was insolvent, executed mortgages to the minority stockholders for money to pay debts and then subsequently the stockholders foreclosed the same. Along the same line, the directors in the *Sweeney Case, supra,* made monthly contributions so the realty development corporation could meet its obligations and in return received lots from the corporation at less than fair market value.

As set forth above, the great weight of authority mitigates against a creditor of a corporation suing a director for negligence or mismanagement. Even assuming, with conceeding, that such a right may exist in limited circumstances, none of such circumstances are raised by

the allegations contained in the plaintiff's numerous complaints.

There is no allegation made by the plaintiff that respondent or any of them acted fraudulently or deceitfully or participated in any self dealing of any kind.

CONCLUSION

By reason of the foregoing, the decision of the lower court dismissing plaintiff's complaint for failure to state a cause of action should be affirmed.

Respectully submitted,

J. Duffy Palmer
40 South 125 East
Clearfield, Utah
Attorney for Defendent-Respondent
Harold Gailey