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The Corporate Guaranty

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THE CORPORATE GUARANTY

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Corporate business, with increasing frequency, is conducted through subsidiary and affiliated corporations. Normally, one or two of the entities in a multi-corporate enterprise enjoy a highly rated credit standing. The remaining corporations, engaged in selling, marketing, maintenance, or other functional activities, are often under-capitalized and cannot alone develop their credit resources. Similarly, many businesses which fall without the pale of the parent-subsidiary-affiliate relationship are commercially interdependent and can operate only with the aid of a corporation whose credit position is strong. Materialmen and contractors, manufacturers and suppliers, sellers and customers typify such relationships connoting a business nexus.

In this complex of the business world, the corporate guaranty plays an important role as a credit device. The business man who extends credit in reliance upon a corporate guaranty looks no further than the assumptively enforceable promise of the guarantor. The corporate counsellor is more wary. Too often he has seen the ground rules operate by a court decision holding that the guarantor's promise was ultra vires and unenforceable. Such a climate of uncertainty, frequently attended by the unenforceability of a putatively binding promise, invites a re-examination of the problem in the light of the applicable cases, statutes and economic considerations. The *dramatis personae* in obvious view are the guarantor, primary obligor, and extender of credit. Off stage but no less involved are the stockholders and intra vires creditors of the corporate guarantor. Present, too, but still further removed from the scene of divergent interests, is the state with its potential remedy of quo warranto.

Almost half of the states have no statutes relating to the corporate guaranty. The remaining states have statutes which in terms sometimes absolute, other times qualified, empower a corporation to act as a guarantor. In addition, during the past twenty-five years many state legislatures have enacted laws abolishing the defense of ultra vires subject to specified exceptions. To what extent does the new legislation afford guides to the corporate lawyer and a road of safer travel for one who extends credit in reliance on the corporate guaranty? A consideration of that question, including a reappraisal of the cases viewed in the light of the new legislation, is the subject of this study.[1]

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1. Our concern is only with the ordinary business corporation and excludes from consideration banking, railroad, trust, public service and other corporations which are accorded special treatment by the law.

I. THE SILENT STATUTES

In twenty-four states[2] the statutes make no specific mention of a corporation's power to guarantee, although the enumeration of general powers in such statutes, expressly or impliedly, includes the power to make contracts. Statutory silence, however, is not tantamount to a negation of the power to guarantee; for the courts in these jurisdictions, on various bases and within prescribed limits, sanction the corporate power to act as a guarantor. The approach of the courts in states with such a statutory pattern is an appropriate starting point.

A. Accommodation and Beyond

When an individual signs negotiable paper as an accommodation maker or indorser, he is liable to a holder for value notwithstanding that such holder at the time of taking the instrument knew such individual to be an accommodation party.[3] Substitute for the individual a corporation and the holder of the negotiable instrument may encounter a sustainable defense. The factual setting is fairly uniform: *B* seeks to borrow money from the plaintiff. The plaintiff will not lend solely in reliance on *B's* credit and insists on greater protection. The defendant corporation signs the note either as an accommodation maker or it is named as a payee and signs as an accommodation indorser, with the plaintiff fully knowledgeable of the defendant's accommodation role. The borrower defaults. In a suit by the lender against the corporate accommodation maker or payee-indorser, the latter pleads ultra vires. The courts uniformly sustain the defense.[4] In such cases, however, where all the stockholders of the guarantor have consented to the guaranty and no injury to creditors' rights is involved, the ultra vires defense will not bar the plaintiff from

2. ALA. CODE ANN. tit. 10 § 70 (1940); Alaska Sess. Laws 1957, ch. 126, § 4; ARIZ. REV. STAT. ANN. § 10-152 (1956); CONN. GEN. STAT. § 33-16 (1958); HAWAII REV. LAWS § 172-23 (1955); ILL. ANN. STAT. c. 32, § 157.5 (Smith-Hurd 1954); KY. REV. STAT. ANN. § 271.125 (1955); ME. REV. STAT. ANN. c. 53, § 16 (1954); MD. ANN. CODE art. 23 § 9 (1957); MASS. ANN. LAWS c. 155 § 6, c. 156 § 4 (1948); MO. ANN. STAT. § 351.385 (1952); MONT. REV. CODES ANN. § 15-801 (1947); NEB. REV. STAT. § 21-103 (1943); N.H. REV. STAT. ANN. § 294:4 (1955); N.J. STAT. ANN. § 14:3-1 (1937); N.D. REV. CODE § 10-1904 (Supp. 1957); ORE. REV. STAT. § 57.030 (1953); S.C. CODE § 12-102 (1952); S.D. CODE § 11.0104 (1939); TEX. BUS. CORP. ACT art. 2.02 (1956); UTAH CODE ANN. § 16-2-14 (1953); VT. STAT. ANN. § 11-101 (1958); WIS. STAT. § 180.04 (1955); WYO. COMP. STAT. ANN. § 44-145 (1945).

3. UNIFORM NEGOTIABLE INSTRUMENTS LAW § 29.

4. Aetna Nat'l Bank v. Charter Oak Life Ins. Co., 50 Conn. 167 (1882); Thompson v. Whitney & Marsh, 17 Hawaii 107 (1905); Foster v. Merkle-Korff Co., 233 Ill. App. 302 (1924); Farmers & Traders Bank v. Thixton, Millett & Co., 199 Ky. 69, 250 S.W. 504 (1923); Savage Mfg. Co. v. Worthington, 1 Gill 284 (Md. 1843); New Hampshire Nat'l Bank v. Garage & Factory Equip. Co., 267 Mass. 483, 166 N.E. 840 (1929); Earl v. Roberts Fuel Oil, Inc., 147 Ore. 646, 35 P.2d 238 (1934). *Cf.* Sun Oil Co. v. Redd Auto Sales, Inc., 159 N.E.2d 111 (Mass. 1959).

recovery.[5] Conversely, in such cases, if injury to creditors' rights is involved the defense of ultra vires will bar recovery[6] notwithstanding the consent of all the stockholders of the guarantor.

The invariable emphasis of the courts, when they sustain the ultra vires defense in this type of case, is the fact of the plaintiff's knowledge that the corporate defendant received no part of the borrowed funds and acted solely to accommodate the borrower.[7] Thus the factors of accommodation and "abuse of power" combine to constitute a defense available to a corporation.[8] The decisions are further fortified by the courts' observations that the corporate charter contains no provision specifically empowering the corporation to indorse negotiable paper for accommodation and by their reluctance to find any implied power.[9] If the plaintiff is a holder in due course without knowledge of the defendant's accommodation role, the defense of ultra vires will not be sustained.[10]

When the facts extend beyond bare accommodation for the borrower, the courts will look askance at the defense of ultra vires.[11] In such a case the courts initially look for an express power of guaranty contained in the charter. In the absence of an applicable charter provision, the courts will attempt to find an implied power whenever the "transaction can reasonably be said to be incidental to the conduct of the business authorized by the charter."[12] In *Talmadge v. Clewiston Iron Co.*,[13] a corporation engaged in developing towns indorsed the note of a company which had contracted to build a steel mill within the territory of the development corporation. Holding the corporate indorser liable as a guarantor, the court was explicit in setting forth the reasoning which underlay the decision:

> We ascribe no special force to the power given in appellant's charter to endorse negotiable notes. We take it that such power is intended to be exercised mainly if not altogether where such notes are given or taken in the course of the corporation's legitimate business, and, therefore, affords little assistance in determining the point in question.

5. Note, 83 U. PA. L. REV. 479, 488 (1935) and cases cited.

6. *Supra* note 5 and cases cited.

7. Foster v. Merkle-Korff Gear Co., 233 Ill. App. 302 (1924); Farmers & Traders Bank v. Thixton, Millett & Co., 199 Ky. 69, 250 S.W. 504 (1923).

8. BRANNAN, NEGOTIABLE INSTRUMENTS LAW 578 (7th ed. 1948).

9. *Supra* note 7.

10. Credit Co. v. Howe Machine Co., 54 Conn. 357, 8 Atl. 472 (1886); Central Trust Co. v. Smurr & Kamen Mach. Co., 191 Ill. App. 613 (1915); Monument Nat'l Bank v. Globe Works, 101 Mass. 57 (1869).

11. See Squaw Gulch Mining & Milling Co. v. Kollberg, 36 Ariz. 442, 286 Pac. 822 (1930) (guaranty of note was considered part payment of purchase price for property received by guarantor).

12. *Supra* note 10.

13. 252 Ill. App. 508 (1929).

> The general principle that a corporation has no implied power to indorse notes for the mere accommodation of another even though it may be *incidentally benefitted* thereby is so well settled as not to need citation of authorities. (Italics supplied.)[14]

After laying a negative groundwork the Illinois court held the guaranty to be enforceable on the grounds that a corporation organized to develop townsites should be considered to have broad enough powers to establish a steel plant, and that recognition of an implied power to erect a steel plant perforce included the power to extend credit by the indorsement of notes for the accomplishment of its purposes. The court's thinking was that by giving the guaranty the guarantor was "directly benefitted."[15] This concept of the degree of benefit to the guarantor extending beyond the scope of bare accommodation is suggestive of the basic approach which the courts take in deciding upon the enforceability of a corporate guaranty.

B. Benefit to the Guarantor

The cases thus far discussed have been concerned with the corporate guarantor within the limited framework of negotiable instruments. More frequently the courts have been faced with the problem of the enforceability of the corporate guaranty as a device employed generally in business transactions. In that broad area considerations of the degree of benefit to the guarantor have been of prime importance in weighing the factual variables. A selective sampling of the cases gives some insight into the meaning of the "benefit" of the criterion. In *Davis v. Old Colony R.R.*,[16] a railroad guaranteed the payment of expenses of a musical festival with the hope that the festival would be an attraction causing increased use of the railroad. The court, in sustaining the defense of ultra vires, did not consider the festival a direct benefit to the guarantor and held that it had acted beyond its implied powers.

A repetitive pattern in the cases is the guaranty of the purchase commitments of the guarantor's supplier. In such a case the Massachusetts court also considered the act of guaranty ultra vires.[17] There are many situations in which the acts of guaranty have been held to

14. *Id.* at 514.

15. *Id.* at 521. *Cf.* Jesselsohn v. Boorstein, 111 N.J. Eq. 310, 162 Atl. 254 (1932) (recognizing direct benefit to corporate mortgagor furnishing security in aid of credit to subsidiary); Eastern Trust & Banking Co. v. Guernsey, 144 Me. 135, 65 A.2d 13 (1949) (holding corporation liable on accommodation indorsement where sole stockholder consented and no creditors involved); Aetna Nat'l Bank v. Charter Oak Life Ins. Co., 50 Conn. 167, 183 (1882) (Dictum: express authority of board of directors would render corporation liable on accommodation indorsement).

16. 131 Mass. 258 (1881).

17. Limerick Mills v. Royal Textile Co., 288 Mass. 479, 193 N.E. 9 (1934).

be only of indirect, remote or incidental benefit to the guarantor, and therefore unenforceable.[18] However, more numerous are the cases in which the act of guaranty has been held to be a direct benefit to, and therefore enforceable against, the guarantor. On substantially identical facts the courts in different states sometimes will reach opposite results. For example, in Illinois, a lumber company which guaranteed performance by its building contractor customer was held to its guaranty.[19] A Texas court reached a contrary decision.[20]

A typical example of the benefit to the guarantor approach is the case of *Edwards v. International Pavement Co.* The defendant was engaged in the business of issuing licenses under patents and contracts for the use of asphalt for block pavements and supplying or causing to be supplied to its licensees the asphalt required by them. To enable its licensees to purchase asphalt from a third party supplier, the defendant guaranteed payment under its licensees' purchase commitments. Suit was brought for an accounting by an income bond holder against the defendant and its directors claiming that the defendant's guaranties in aid of its licensees were ultra vires. In holding that the guaranties were not ultra vires, the court said:

> [T]he defendant's business was issuing licenses under its patents and contracts. The licensees at no time exceeded seven in number and often were in financial difficulties. Without the defendant's guaranty they could have obtained no asphalt and the result would be that the defendant's business would have been at a standstill. The master finds that the defendant met with a loss in only one instance . . . .[21]

The Massachusett court emphasized the peculiar nature of the business in conjunction with the charter provision empowering the corporation "generally to do all things incidental to said business and the proper management thereof." The same court, ten years later, rested its decision on the single ground of a charter provision but it observed in an aside that a guarantor holding three mortgages upon the prop-

18. Best Brewing Co. v. Klassen, 185 Ill. 37, 57 N.E. 20 (1900), *reversing* 85 Ill. App. 464 (1900) (brewery acted as surety on customer's appeal bond); Culhane v. Swords Co., 281 Ill. App. 185 (1935) (indorsement of note of corporate officer on personal loan). See especially Texas cases: Rio Grande Valley Gas Co. v. Grand Rapids Store Equip. Corp., 57 S.W.2d 348 (Tex. Civ. App. 1933) (gas corporation guaranteed purchase commitment of its customer, appliance company); Bowman Lumber Co. v. Pierson, 110 Tex. 543, 221 S.W. 930 (1920) (lumber company acted as surety for building contractor under agreement to purchase lumber from guarantor); Deaton Grocery Co. v. International Harvester Co., 47 Tex. Civ. App. 267, 105 S.W. 556 (1907) (customer's indebtedness to others guaranteed to obtain extension of time for customer). See also 6 FLETCHER, PRIVATE CORPORATIONS ch. 26 (perm. ed. rev. repl. 1950); Slover, *Enforceability of Guaranties made by Texas Corporations*, 10 SW. L.J. 134 (1956).

19. Central Lumber Co. v. Kelter, 201 Ill. 503, 66 N.E. 543 (1903).

20. *Supra* note 18.

21. 227 Mass. 206, 212, 116 N.E. 266 (1917).

erty of the primary obligor had sufficient interest in its "affairs and prosperity" to support the guaranty.[22] It is clear that whenever the facts point toward a direct as distinguished from an indirect benefit, the guarantor will be held to its promise.[23]

C. Other Supporting Bases

The determination that the benefit to the guarantor is direct and not indirect is a mixture of conclusion and supporting basis. Sometimes the facts will lead a court to frame a theory specifically designed for the case.

Estoppel is the most frequently mentioned supporting basis in the decisions. Some courts take the position that the contract is ultra vires but that the corporate guarantor should be estopped to deny its liability; other courts will say that even if the contract is not ultra vires, the corporate guarantor should be estopped.[24] As in many other areas in the law, the courts have found that the doctrine of estoppel is a good working hypothesis to accomplish just results and an effective answer to the corporate guarantor which seeks to retain the benefits and reject the burdens.

The principle of "equitable assignment" was applied by a Vermont court, without mention of benefit to the guarantor, in granting part of a claim asserted by a bank against the assignee for creditors of a corporate indorser which had indorsed a note of one of its officers.[25] On the facts of the case the decision could have been justified on the direct benefit basis.

A still different theory, similarly equated to the direct benefit approach, was employed by a federal court applying Massachusetts law.[26] The guarantor (a bankrupt debtor) while engaged in the building supplies business organized a real estate corporation, the stock of which was issued to the guarantor's stockholders. The two corporations had common directors and officers. A decedent had made a loan

22. Bennett v. Corporation Fin. Co., 258 Mass. 306, 313, 154 N.E. 835 (1927).

23. See Midland Tel. Co. v. Nat'l Tel. News Co., 236 Ill. 476, 86 N.E. 107 (1908); North Texas State Bank v. Browley-Southerland Comm'n Co., 145 S.W. 1027 (Tex. Civ. App. 1912); H. Seay & Co. v. Moore, 265 S.W. 376 (Tex. Comm. App. 1924). See also 6 FLETCHER, PRIVATE CORPORATIONS ch. 26 (perm. ed. rev. repl. 1950). *Cf.* American Sur. Co. v. 14 Canal St., Inc., 276 Mass. 119, 176 N.E. 785 (1931) and Broadway Nat'l Bank v. Baker, 176 Mass. 294, 57 N.E. 603 (1900).

24. See Note 83 U. PA. L. REV. 479, 482 (1935); see also McCornick & Co. v. Citizens Bank, 304 Mo. 270, 263 S.W. 152 (1924); Eddleman v. Wofford, 217 S.W. 221 (Tex. Civ. App. 1919); *cf.* Lohrer v. Charles F. Vogel Real Estate Co., 239 S.W. 1098 (Mo. App. 1922).

25. Howland Bros. & Cave v. Barre Saving Bank & Trust Co., 89 Vt. 290, 95 Atl. 679 (1915). *Cf.* Culhane v. Swords Co., 281 Ill. App. 185 (1935) (corporate indorsement of note of officer given for personal loan was held ultra vires).

26. *In re* Duncan & Goodell Co., 15 F. Supp. 550 (D. Mass. 1936).

to the real estate corporation. The loan was evidenced by a note indorsed by the bankrupt and further secured by the bankrupt's separate written guaranty. The proceeds of the loan were used to erect a building occupied by the bankrupt. The court allowed the claim on the note and in holding that the guaranty was not ultra vires stated at page 552:

> The doctrine of *purchase-money resulting trusts*, while more often applied in cases of real estate, is equally applicable to transfers of personal property, the purchase price for which is paid by one, and the title to which is taken in the name of another. (Italics adopted.)
>
> . . . .
>
> The interest of the present debtor in the realty company, therefore, does not differ substantially from that of a corporation in a *wholly-owned subsidiary* . . . . (Italics supplied.)

On the facts of the case it would appear that the simple benefit theory would have been less strained and more applicable than the combination of the purchase-money resulting trust and an analogy to the parent-subsidiary relationship.

When there is no available statutory guide, the courts frequently look for an empowering provision in the corporate charter. Present such a provision, none of the courts have upheld the enforceability of a corporate guaranty solely in reliance upon the inclusion of the power in the corporate charter. Rather, they look for a supporting basis of direct benefit to the guarantor. In fact, the courts' approach is identical when the corporate charter contains no power of guaranty. It would seem, therefore, that the courts merely pay lip service to the inclusion of the power provision and actually decide the cases on the basis of the degree of benefit to the guarantor.[27]

A finding of benefit sufficient to support the enforceability of a corporate guaranty has a more subtle aspect than the measurements of the degree of benefit to the guarantor. Thus, when the intra vires creditors of a bankrupt guarantor assert claims the courts are prone to view the promise of the guarantor as ultra vires on facts which would otherwise permit of the inference of a direct benefit.[28] In such a situation, ratification by all the stockholders will not cure the ultra vires character of the guarantor's promise so as to defeat the rights of intra vires creditors.[29]

The courts' protective attitude for intra vires creditors—and stockholders—of the corporate guarantor is evidenced when they compare

27. *Supra* notes 16 through 22; see also *In re* Gilchrist Co., 278 Fed. 235, 239 (D. Mass. 1922).
28. *In re* Gilchrist Co., 278 Fed. 235, (D. Mass. 1922); *In re* Prospect Worsted Mills, 126 Fed. 1011 (D. Mass. 1904).
29. See *In re* Prospect Worsted Mills, 126 Fed. 1011 (D. Mass. 1904).

the probable risk of the contingent obligation of the guaranty to the probable benefit derivable from the contract. If the risk to the corporate guarantor is disproportionate to the probably realizable benefit, the ultra vires defense will be sustained.[30] Thus, the standard of the degree of benefit is frequently resolved in terms of commercial soundness.

From the foregoing review of cases which have arisen in the states wherein statutes do not specifically empower a corporation to act as a guarantor the bases for decision vary and are frequently tailored to support the results which the courts seek to attain. A pertinent inquiry, therefore, is whether more certain standards are afforded in those states wherein statutes expressly empower a corporation to act as a guarantor.

II. STATUTORY GUIDES

A. Statutes Granting the Power to Guarantee

Twenty-six states by statute expressly empower a corporation to act as a guarantor.[31] In fifteen of such states, the statutory grant of power is, on the face of the statute, absolute.[32] Statutes in five other states are similarly broadly worded but are coupled with the qualifying condition that the exercise of the power must be to accomplish the purpose recited in the articles of incorporation.[33] The remaining six states have statutes peculiarly expressive of each state's own public policy. The basic provisions of these statutes are as follows:

California[34]—Prohibits, except by a vote or written consent of the holders of two-thirds of the shares of all classes, voting and non-

30. See Note, 83 U. PA. L. REV. 479, 484-88 (1935), which contains a full discussion of various transactions and cases relating the contingent obligation of guaranty to the probable realization of benefit.

31. ARK. STAT. ANN. § 64-109(c) (1947); CAL. CORP. CODE ANN. § 823 (Deering 1947); COL. CORP. ACT § 4(f)(i) (1959); DEL. CODE ANN. tit. 8, § 123 (1953); FLA. STAT. ANN. § 608.13(9)(a) (1956); GA. CODE ANN. § 22-1828(c) (Supp. 1958); IDAHO CODE ANN. § 30-114(2)(d) (1948); IND. ANN. STAT. § 25-202(b)(7) (1948); IOWA BUS. CORP. ACT, § 4(8) (1959); KAN. GEN. STAT. ANN. § 17-3001(E) (1949); LA. REV. STAT. ANN. § 12:12(C) (1950); MICH. STAT. ANN. § 21.10(i) (Supp. 1957); MINN. STAT. ANN. § 301.10 (1947); MISS. CODE ANN. § 5325 (1942); NEV. REV. STAT. § 78.070(2) (1957); N.M. STAT. ANN. § 51-3-21 (1953); N.Y. STOCK CORP. LAW § 19; N.C. GEN. STAT. § 55-17(b)(3) (Supp. 1959); OHIO REV. CODE ANN. § 1701.13(f)(5) (Baldwin 1959); OKLA. STAT. ANN. tit. 18, § 1.19(7) (1951); PA. STAT. ANN. tit. 15, § 2852-302(6) (1958); R.I. GEN. LAWS ANN. § 7-2-10(i) (1956); TENN. CODE ANN. § 48-117(8) (1956); VA. CODE ANN. § 13.1-3(g) (1950); WASH. REV. CODE § 23.01.120 (1951); W. VA. CODE ANN. § 3077 (1955).

32. See note 31 *supra* (Arkansas, Delaware, Florida, Idaho, Indiana, Iowa, Kansas, Michigan, Mississippi, Nevada, Ohio, Oklahoma, Tennessee, Virginia, and West Virginia).

33. See note 31 *supra* (Louisiana, Minnesota, Pennsylvania, and Washington). *Cf.* Rhode Island (permissible only "if authorized so to do by its charter").

34. CAL. CORP. CODE ANN. § 823 (West 1956).

voting, the guaranty, directly or indirectly, of the obligation of any director or officer of the corporation or of any holding or subsidiary corporation thereof or the guaranty of any person other than such director or officer, upon the security of the shares of the corporation or the shares of any holding or subsidiary corporation thereof. Shares held by the benefited director, officer or shareholder are not counted in determining the required vote. Directors or officers who authorize or assent to a violation of the statute are, subject to rights of contribution against participants, jointly and severally liable to the corporation as guarantors for any liability on the guaranty plus six per cent interest.

Colorado[35]—In addition to a generally stated power to guarantee the obligations of others "for its corporate purposes," a corporation enjoys unqualified power to guarantee the obligations of its employees, and upon the vote of at least two-thirds of the shares entitled to vote for directors, may guarantee the obligations of its directors and officers.

Georgia[36]—The power to guarantee is granted as to those matters in which it has a direct interest. Specifically denied is the power ("right") to guarantee as to those matters in which it has no direct interest or "to make any purely accommodation guaranty, endorsement or contract of suretyship, unless such right to guarantee or endorse or become surety is contained in the charter or an amendment...."

New Mexico[37]—The power to guarantee is in all instances subject to the combined approval of two-thirds of the directors and two-thirds of the outstanding stock, in each case expressed at a meeting.

New York[38]—The New York statute, more detailed in coverage than the statutes of the other states and with a more extensive history, is accorded separate treatment hereinafter.[39]

North Carolina[40]—The grant of power is specific: "To enter into contract of guaranty or suretyship or make other financial arrangements for the benefit of its personnel or customers or suppliers."

B. Statutes Abolishing the Defense of Ultra Vires

The statutory setting outlined is incomplete without mention of the recent statutes which abolish the defense of ultra vires in suits between a corporation and a third party. One who extends credit in

35. COLO. REV. STAT. ANN. 331-27-4 (Supp. 1959).
36. GA. CODE ANN. § 22-1828 (Supp. 1958).
37. N.M. STAT. ANN. § 51-3-21 (1953).
38. N.Y. STOCK CORP. LAW § 19.
39. *Infra*, pages 244 to 251.
40. N.C. GEN. STAT. § 55-17 (Supp. 1959).

reliance upon a corporate guaranty would qualify as a third party within the statutory framework. By the same token it is reasonable to assume that in a state having a statute specifically empowering a corporation to guarantee and a statute abolishing the defense of ultra vires the judicial technique would be to read the statutes together. Of the twenty-six states which specifically empower a corporation to guarantee, twelve have a statute which abolishes the defense of ultra vires.[41] Significant, too, is the fact that of the twenty-four states which have no statute touching upon the power of a corporation to guarantee, ten of these have statutes which abolish the defense of ultra vires.[42]

The content of this new type of statute is not uniform among the states. The Model Business Corporation Act[43] version has been adopted (sometimes with slight variations, as in North Carolina) in twelve states.[44] Generally stated, this relatively recent legislation is

41. CAL. CORP. CODE ANN. § 803 (West 1956); COLO. CORP. ACT. § 6 (1959); FLA. STAT. ANN. § 608.50 (1956); IOWA BUS. CORP. ACT § 6 (1959); KAN. GEN. STAT. ANN. § 17-4101 (1949); MICH. STAT. ANN. § 21.11 (1937); MINN. STAT. ANN. § 301.12 (1947); N.C. GEN. STAT. § 55-18 (Supp. 1959); OHIO REV. CODE ANN. § 1701.13 (Baldwin 1958); OKLA. STAT. ANN. tit. 18, § 1.29 (1951); PA. STAT. ANN. tit. 15, § 2852-303 (1958); VA. CODE ANN. § 13.1-5 (1950).

42. Alaska Sess. Laws 1957, ch. 126, § 6; D.C. CODE ANN. § 29-905 (Supp. 1959); ILL. ANN. STAT., ch. 32, § 157.8 (Smith-Hurd 1954); MD. ANN. CODE art. 23, § 124 (1957); MO. ANN. STAT. § 351.395 (1952); N.D. REV. CODE § 10-1906 (Supp. 1957); ORE. REV. STAT. § 57.040 (1957); TEX. BUS. CORP. ACT art. 2.04 (1956); VT. STAT. ANN. § 11-133 (1958); WIS. STAT. ANN. § 180.06 (1957).

43. ABA-ALI MODEL BUS. CORP. ACT § 6 (1953):

"Defense of Ultra Vires

"No act of a corporation and no conveyance or transfer of real or personal property to or by a corporation shall be invalid by reason of the fact that the corporation was without capacity or power to do such act or to make or receive such conveyance or transfer, but such lack of capacity or power may be asserted:

"(a) In a proceeding by a shareholder against the corporation to enjoin the doing of any act or acts or the transfer of real or personal property by or to the corporation. If the unauthorized acts or transfer sought to be enjoined are being, or are to be, performed or made pursuant to any contract to which the corporation is a party, the court may, if all of the parties to the contract are parties to the proceeding and if it deems the same to be equitable, set aside and enjoin the performance of such contract, and in so doing may allow to the corporation or to the other parties to the contract, as the case may be, compensation for the loss or damage sustained by either of them which may result from the action of the court in setting aside and enjoining the performance of such contract, but anticipated profits to be derived from the performance of the contract shall not be awarded by the court as a loss or damage sustained.

"(b) In a proceeding by the corporation, whether acting directly or through a receiver, trustee, or other legal representative, or through shareholders in a representative suit, against the incumbent or former officers or directors of the corporation.

"(c) In a proceeding by the Attorney General, as provided in this Act, to dissolve the corporation, or in a proceeding by the Attorney General to enjoin the corporation from the transaction of unauthorized business."

44. Alaska Sess. Laws 1957, ch. 126, § 4; COLO. REV. STAT. ANN. § 6; D.C. CODE ANN. § 29-905 (Supp. 1959); ILL. ANN. STAT. c. 32 § 157.8 (Smith-Hurd 1954); IOWA BUS. CORP. ACT § 6 (1959); MD. ANN. CODE art. 23, § 124 (1957); N.C. GEN. STAT. § 55-18 (Supp. 1959); N.D. REV. CODE § 10-1906 (Supp. 1957);

designed to protect third parties dealing with corporations, to provide for enjoining the performance of ultra vires executory contracts and to preserve the remedies against wrongdoing officers and directors and the right of the state to take appropriate action. Other states have incorporated in their statutes provisions which in some instances purport to afford even greater protection to third persons[45] and in other instances permit of the ultra vires defense against a third party with actual knowledge of the limitations of corporate authority.[46]

Statutes abolishing the defense of ultra vires are intended, of course, to cover the full range of possible transactions which may generally be characterized as the abuse of corporate power.[47] The corporate gnaranty is only one aspect of the problem. In fact, in all states but one which have this type of legislation, the statutory sections relating thereto are separate and apart from provisions pertaining to corporate powers in general and the power to guarantee in particular. The one exception is Ohio where the statutory section covering corporate powers includes, in addition to the guaranty power, the prohibition against the defense of ultra vires.[48]

ORE. REV. STAT. § 57.040 (1957); TEX. BUS. CORP. ACT art. 2.04 (1956); VA. CODE ANN. § 13.1-5 (1950); WIS. STAT. ANN. § 180.06 (1957).

45. CAL. CORP. CODE ANN. § 803(c) (West 1947): "Any contract . . . which is . . . done within the scope of the authority, actual or apparent, given by the directors . . . binds the corporation . . . whether the contract is executed or wholly or in part executory." FLA. STAT. ANN. § 608.50 (1956): "The defense of ultra vires shall not be available to a corporation sued on a contract or other obligation." OKLA. STAT. ANN., tit. 18, § 1.29 (1951): applies both to executed and executory contracts and bars defense of ultra vires if "the articles of incorporation . . . be ambiguous as to the scope of its corporate purposes and under any reasonable interpretation of the articles of incorporation as relied upon by any third party, or his privy, the transaction in question would have been authorized." PA. STAT. ANN. tit. 15, § 2852-303 (1958): bars ultra vires defense based upon limitation upon the "business, purpose or purposes, or powers of a business corporation, expressed or implied in its articles or implied by law." VT. STAT. ANN. § 11-1 (1958): "When an act done in behalf of a corporation is authorized or ratified by the directors or trustees, or such act is done within the scope of authority given by the directors or trustees, provided that a corporation with authority to do such act might have been formed under the laws of this state at the time it was done, such act shall be regarded as the act of the corporation and the corporation shall be liable therefor, even if such act was not necessary or proper to accomplish its purposes, to the same extent that it would have been liable for such act had it been necessary or proper to accomplish its purposes." *Cf.* MO. ANN. STAT. § 351.395 (1952) (limiting denial of defense of ultra vires to transactions involving conveyances and acquisitions of real and personal property wherein directors or officers acting within scope of actual or apparent authority given by directors exceed purposes or powers of corporation).

46. KAN. GEN. STAT. ANN. § 17-4101 (1949); MICH. STAT. ANN. § 21.11 (1937); MINN. STAT. ANN. § 301.12 (1947).

47. Abuse of corporate power in the doing of an illegal or immoral act would appear not to fall within the protective coverage of these statutes. See OKLA. STAT. ANN. tit. 18, § 1.29 (1951) ("This section shall not be construed to validate or prohibit a defense against an illegal or immoral contract, prohibited by law or by the public policy of the State").

48. OHIO REV. CODE ANN. § 1701.13(F)(5) and (H) (Baldwin 1958).

What effect do the statutes granting the power to guarantee and abolishing the defense of ultra vires have upon the old case law? In what way have they been viewed by the courts? For an appraisal of the effect of the statutes, some of the older cases, decided before the enactment of the new legislation, provide instructive background for an appreciation of recent decisions.

C. The Cases

A bare accommodation indorser or maker of negotiable paper, with knowledge by a holder of the accommodation nature of the guaranty, is a fertile factual setting for the defense of ultra vires.[49] Here too, as in the states without benefit of a statutory guide, this rule is subject to the following qualification: where all the stockholders of the guarantor have consented to the guaranty and no injury to creditors' rights is involved, the ultra vires defense will not bar the plaintiff from recovery; and conversely, notwithstanding the consent of all the stockholders of the guarantor, if injury to creditors' rights is involved, the defense of ultra vires will bar recovery.[50] The guarantor is not liable on his contractual guaranty when the promisor, to the knowledge of the plaintiff, is a pure accommodator.[51] Even the hope of obtaining business as a motive for the indorsement of a note does not bar the defense of ultra vires, in the absence of a resolution of the board of directors or stockholders or a provision in the charter of the corporation expressly or impliedly authorizing an officer to sign as an accommodation indorser.[52] When the plaintiff is without knowledge of the accommodation nature of the indorsement or guaranty, the ultra vires defense will not be sustained.[53] It would thus appear that the foregoing old line cases in the states with statutes empowering a corporation to act as a guarantor are similar in rationale and result to the cases decided by the courts in the states which are without benefit of such a statute.[54]

The courts have indicated an awareness of the impact of the new legislation. In *Thomas v. E. G. Curtis Sons Co.*, a bank receiver sued

49. Simmons Nat'l Bank v. Dilley Foundry Co., 95 Ark. 368, 130 S.W. 162 (1910) (Dictum: If all stockholders had consented and no creditors were injured, ultra vires defense would not be sustained); J. Schnarr & Co. v. Virginia-Carolina Chemical Corp., 118 Fla. 258, 159 So. 39 (1934); First Nat'l Bank v. Galloway Bros., 193 Iowa 1145, 188 N.W. 803 (1922); Brinson v. Mill Supply Co., 219 N.C. 498, 14 S.E.2d 505 (1941); Ketcham v. Mississippi Outdoor Displays, Inc., 203 Miss. 52, 33 So. 2d 300 (1948); National Bank v. Waynesboro Knitting Co., 315 Pa. 334, 172 Atl. 130 (1934).

50. *Supra* notes 5 and 6.

51. Stone-Ordean-Wells Co. v. New England Pie Co., 201 Mich. 407, 167 N.W. 943 (1918).

52. Proctor v. Opelousas Ins. Agency, 181 La. 79, 158 So. 627 (1934).

53. Henderson Lumber Co. v. Chatham Bank & Trust Co., 33 Ga. App. 196, 125 S.E. 867 (1924).

54. See notes 4 through 10 *supra*.

on an accommodation indorsement of a dissolved corporation. The bank had known of the accommodation nature of the indorsement. In refusing to sustain the defense of ultra vires, the court said:

> [I]f the creditors have been paid in full and if the stockholders have consented to the ordinarily unauthorized act, it would seem in equity that there is no good reason why a corporation and its stockholders, upon the basis of estoppel, should not be held liable.
>
> . . . .
>
> Furthermore, the court is inclined to interpret the statute of Michigan as including power to execute accommodation papers. Members of the committee which drafted the 1931 Michigan Code state that the power to guarantee does not extend to accommodation undertakings, but in 14a Corpus Juris, 734, it is said that: "The power to issue or endorse accommodation paper will be implied, however, from an express or implied power in the corporation to become surety or guarantor."
>
> This power implied from the power to execute guaranty or surety contracts seems entirely reasonable in view of the language of the Michigan Statute.
>
> Furthermore, it may be logically argued that only the state could complain of a violation of the Statute.[55]

The court stressed the fact of stockholders' consent coupled with non-injury to creditors and therefore its reference to the effect of the statute as empowering a corporation to execute accommodation paper may be viewed as dictum. Comparison should be made with *Talmadge v. Clewiston Iron Co.*[56] which arose in a jurisdiction without a guaranty statute. In the *Talmadge* case, the Illinois court regarded a charter provision empowering a corporation to indorse negotiable notes as an insufficient basis for an accommodation indorsement and required the additional factor of direct benefit to the guarantor. Conversely, in the *Thomas* case, a federal court, applying the Michigan statute, ascribed to it the meaning of a literal mandate without requiring the further proof of benefit to the guarantor. Pointedly relevant is the Georgia statute which provides that a corporation "shall not . . . make any purely accommodation guaranty, endorsement or contract of suretyship, unless such right to guarantee or endorse or become surety is contained in the charter of the corporation or an amendment lawfully made thereto."[57] Thus, the Georgia statute goes further than the *Talmadge* case[58] by not requiring the condition of direct benefit to the guarantor where the power to indorse is contained in the charter. However, the Georgia statute pulls up short of the *Thomas* case[59] in requiring a charter provision as a con-

55. 7 F. Supp. 114, 115-17 (E.D. Mich. 1934).
56. *Supra* note 13.
57. GA. CODE ANN. § 22-1828(c) (Supp. 1958).
58. *Supra* note 13.
59. *Supra* note 55.

dition for sanctioning the enforceability of a "purely accommodation guaranty."

In *Strauss v. W. H. Strauss & Co.*,[60] the defendant, a tobacco wholesaler, indorsed a note for the accommodation of its officer. The company became insolvent; a receiver was appointed, and its assets were liquidated. The receiver's accounts were before the court for audit. Creditors of the defendant filed objections to the allowance of the payee's claim, contending that the indorsement was ultra vires. The appellate court, in reversing the judgment below in favor of the objecting creditors, conceded that the accommodation indorsement was ultra vires, pointing out that the defendant guarantor had received no benefit from the transaction and said:

> However, section 303 subd. A, of the Business Corporation Act . . . provides: "No limitation upon the business purpose or purposes, or powers of a business corporation, expressed or implied in its articles or implied by law, shall be asserted in order to defend any action at law or in equity between the corporation and a third person, or between a stockholder and a third person involving any contract to which the corporation is a party or any right of property or any alleged liability of whatsoever nature."
>
> Since this act became effective, the defense of ultra vires can no longer be asserted by a corporation in an action involving a contract such as this one, to which it is a party. 199 Atl. at 197.

To date, *Strauss v. W. H. Strauss & Co.* and *In re Dissolution of New Oxford Shoe Co.*[61] appear to be the only two reported cases in which the new legislation abolishing the defense of ultra vires is considered specifically in relation to the ultra vires aspect of the corporate guaranty. It is noteworthy that the courts have given like effect to the same or a substantially similar statute in situations not involving a corporate guaranty.[62] Recently, the Kansas court refused to countenance a claim of ultra vires,[63] but in so doing made no

60. 330 Pa. 517, 199 Atl. 195 (1938). *Accord, In re* Dissolution of New Oxford Shoe Co., 45 Pa. D.&C. 53 (C.P. 1942) (Strauss v. W. H. Strauss & Co. cited and statute abolishing the defense of ultra vires referred to).

61. 45 Pa. D.&C. 53 (C.P. 1942).

62. California Canning Peach Growers v. Hartley, 11 Cal. App. 2d 188, 78 P.2d 1137 (1938); Royal Drug Co. v. Jacob Levin, 273 Ill. App. 231 (1934) (defense of ultra vires claiming plaintiff did not have power to lend under its charter was not sustained); Roddis Lumber & Veneer Co. v. American Alliance Ins. Co., 330 Mich. 81, 47 N.W.2d 23 (1951); Brogan v. Bright-Brooks Lumber Co., 138 Pa. 409, 11 A.2d 205 (1940); Nolan v. J. & M. Doyle Co., 338 Pa. 398, 13 A.2d 59 (1940). *Cf.* Pratt v. Valliquette, 338 Mich. 397, 61 N.W.2d 648 (1953), where the court, in validating a chattel mortgage, in a sound decision on the facts held, in effect, that the giving of the mortgage was ultra vires. It made no mention of the Michigan statute abolishing the defense of ultra vires.

63. Rostocil v. United Oil & Gas Royalty Ass'n, 177 Kan. 15, 274 P.2d 761 (1954).

mention of the applicable statute.[64] It relied solely on its pioneering decision[65] handed down more than fifty years ago.

The doctrine of the degree of benefit to the guarantor so consistently employed by the courts of the states without statutes granting an express power to guarantee is applied in like measure by the courts of the states with such statutes.[66] Sometimes a court will not rest its decision on the theory of benefit but will rely on the concept of implied power.[67] The same factual patterns repeat themselves with the same effect.[68] However, two recent cases in these states indicate a veering from the traditional approach to the problem of the corporate guaranty.

John S. Barnes Inc. v. Paducah Box & Basket Co.[69] was decided before the enactment of the Florida statute abolishing the defense of ultra vires.[70] The language of the opinion anticipates the unequivocal mandate of the statutory provision:

> The record shows that the contract of guaranty was executed within the charter powers of the corporation; that the goods were sold and delivered on the strength of the guaranty. . . . The record shows that the guarantee was signed and mailed to the plaintiff in the regular course of business and by an agent of the defendent acting within the scope of his apparent authority. 2 So.2d at 863.

The opinion neither refers to the charter powers nor mentions the idea of benefit to the guarantor as the basis for enforceability. The court, in effect, subscribed to the theory of the naked power to guarantee, qualified only by the condition of apparent authority of the agent executing the instrument of guaranty.

64. KAN. GEN. STAT. ANN. § 17-4101 (1949).
65. Harris v. Independence Gas Co., 76 Kan. 750, 92 Pac. 1123 (1907).
66. Wasson v. American Can Co., 189 Ark. 354, 72 S.W.2d 241 (1934) (bank liable as guarantor of acceptances given in payment of cans purchased by bank's customer-depositor).
67. Low v. Central Pac. R.R., 52 Cal. Rep. 53 (1877) (railroad corporation guaranteed bonds of another railroad corporation). *Cf.* North American Life Ins. Co. v. Remedial Fin. Corp., 178 Okla. 248, 62 P.2d 491 (1936) (life insurance corporation's guaranty of note of its agent enforceable "in furtherance of its business").
68. Guaranties enforced: William Bros. Lumber Co. v. Young Men's Syrian Ass'n, 65 Ga. App. 480, 15 S.E.2d 908 (1941) (lumber corporation acted as surety on bond of building contractor); Timm v. Grand Rapids Brewing Co., 160 Mich. 371, 125 N.W. 357 (1910) (brewing corporation gave bond to secure sureties on a liquor dealer's bond of one of its customers); First Nat'l Bank v. Pacific Elevator Co., 159 Minn. 94, 198 N.W. 304 (1924) (guarantor had substantial stock interest in primary obligor); M. Burg & Sons, Inc. v. Twin City Four Wheel Drive Co., 140 Minn. 102, 167 N.W. 300 (1918) (guaranty of purchase of furniture by employee). *Cf.* Atlantic Refining Co. v. Ingalls & Co., 37 Del. 503, 185 Atl. 885 (1936) (guaranty not enforceable because of lack of evidence of guarantor's "apparent interest" in primary obligor).
69. 147 Fla. 362, 2 So.2d 861 (1941).
70. FLA. STAT. ANN. § 608.50 (1955).

Choctaw Lumber Co. v. Atlanta Band Mill, Inc.[71] arose in a state which has no statute abolishing the defense of ultra vires. The statute expressly empowering a corporation to guarantee had been amended and made more specific prior to the decision. The suit was on two contracts of guaranty reciting that they were given to induce the plaintiff to extend credit to a sales agency of the defendant. The defendant-guarantor and its sales agency had common shareholders, directors, and officers. The defendant, by board resolution, had authorized the guaranty. In holding the defendant liable, the court, in effect, viewed the new statute[72] not as a codification of the common law of Georgia, but as an enlargement of powers previously enjoyed by corporations under the prior law. The court said: "The latter code certainly enlarged the meaning of the former to some extent as to the power of corporations to enter into guaranty contracts entered upon a valid consideration." 77 S.E.2d at 335.

The statutory and case materials thus far discussed indicate the various factors which the courts consider in deciding upon the enforceability of a corporate guaranty. Unique among the states is New York whose statute has had a long history of changes. A review of its applicable legislation and case law follows.

III. NEW YORK

The present New York statute[73] had six predecessors. The first enactment[74] made no mention of the power to guarantee. It merely empowered a domestic corporation to invest its funds in the stocks, bonds, or securities of other corporations, within narrowly defined limits. The second statutory phase granted a stock corporation power, pursuant to the unanimous vote of stockholders, to guarantee the bonds of any other domestic corporation engaged in the same general line of business[75]—in effect an extension of the power to acquire bonds. Then came a further extension of power enabling a parent corporation engaged in the same general line of business as its subsidiary, pursuant to a two-thirds vote of stockholders, to guarantee the bonds of the subsidiary.[76] Restrictions were again relaxed by permitting a stock corporation, subject to the unanimous vote of stockholders, upon call of a majority of the directors, to guarantee the bonds of any other domestic corporation engaged in the same general line of business and by permitting a parent corporation, pursuant to

71. 88 Ga. App. 701, 77 S.E.2d 333 (1953), *appeal dismissed,* 210 Ga. 166, 78 S.E.2d 515 (1953).
72. *Supra* note 36.
73. N.Y. STOCK CORP. LAW § 19.
74. New York Laws of 1890, ch. 564, § 40, being ch. 36 of the General Laws.
75. Laws of New York 1892, ch. 688, § 40.
76. Laws of New York 1902, ch. 601, § 1.

a two-thirds vote of stockholders, upon call of a majority of the directors, to guarantee the bonds of a wholly owned domestic stock corporation.[77] Then, further relaxation: Any stock corporation was empowered to guarantee the bonds of any other corporation engaged in the same general line of business, upon written consent or vote of stockholders having voting power, or upon the two-thirds vote of stockholders having voting power if the guarantor corporation owned a majority of the voting shares of the corporation whose bonds were guaranteed.[78] Restriction lifting continued: Any stock corporation could guarantee the bonds of any other corporation upon the unanimous consent or vote of two-thirds of the shares entitled to vote or solely by board approval of the guarantor corporation if the latter owned at least two-thirds of the voting shares of the corporation whose bonds were guaranteed.[79]

The present New York statute,[80] enacted in 1944, reads as follows:

> Section 190. Power to Guarantee Obligations for the Payment of Money.
>
> Any stock corporation may guarantee any obligation for the payment of money (a) when the guaranty is made in connection with, and incidental to, the exercise by such corporation of its corporate rights, powers, purposes, privileges and franchises, or (b) when the guaranty is made in connection with the negotiation by such corporation, by sale or otherwise, of an obligation owned by it, or (c) when the obligation to be guaranteed is that of another corporation at least a majority of the voting shares of which is at the time owned, directly or indirectly, by the guarantor corporation and when the guaranty is authorized or approved by a resolution of the board of directors of the guarantor corporation, or (d) when the guaranty is specifically authorized or approved by the affirmative vote of the holders of at least two-thirds of all the outstanding shares of such corporation entitled to vote thereon cast at a meeting called pursuant to section forty-five or by the written consent, without a meeting, of the holders of all its outstanding shares entitled to vote thereon; provided, that nothing in this section contained shall be deemed to deny, limit or restrict the powers of guaranty or warranty possessed by any stock corporation at common law, or by a special act creating or governing such corporation, or under any other statute, or to authorize a stock corporation not organized under or subject to the banking law or the insurance law to transact the business of a moneyed corporation.

It should be observed that prior to the enactment of the present New York statute in 1944, the statutes, with one exception,[81] by their terms limited the power of a corporation to guarantee bonds. The New

77. New York Laws of 1909, ch. 61, which was ch. 59 of the Consolidated Laws.
78. Laws of New York, 1923, ch. 787.
79. Laws of New York, 1940, ch. 464.
80. N.Y. STOCK CORP. LAW § 19.
81. The 1890 law made no mention of the power to guarantee. See note 74 *supra*.

York courts, however, throughout the period of limited statutory grant of power and prior thereto, recognized a broader power to guarantee obligations than was indicated by the narrow statutory sanction. A review of the decided cases against the statutory background with specific reference to the fourfold categories of permissive grants of power is submitted. Preliminarily, it should be noted that the grant of power in the four specified categories is in the disjunctive.

A.

> "(a) [W]hen the guaranty is made in connection with, and incidental to, the exercise by such corporation of its corporate rights, powers, purposes, privileges and franchises. . . ."

The statutory prescription is suggestive of the familiar phrasing, variably couched in terms of "in furtherance of the purposes," a "power implied" from a power expressed, or "for the benefit of the guarantor."

The brewery cases lead the way. A saloonkeeper, without independent credit standing, negotiated for a lease. The lessor demanded that the brewery guarantee the lessee's obligations under the lease. The brewery complied. The lessee defaulted in payment of rent. In an action by the lessor against the brewery-guarantor, the defensive plea was ultra vires. The courts held the brewery liable on the theory of benefit to the guarantor.[82] When a brewery, to hedge against contingent liability as a guarantor, obtained an indemnification undertaking from a defendant, and after paying the assignee of a lessor in honoring its (brewery's) guaranty, sought to recover against the indemnitor, the latter argued that the brewery's agreement to guarantee was ultra vires, unenforceable against it and therefore the brewery should not prevail as against its indemnitor. The court held that the act of guaranty was beneficial to and in furtherance of the business purposes of the brewery and rendered judgment for the plaintiff.[83] A variation of this pattern of parties occurred when the plaintiffs, owners of a hotel and restaurant, in negotiating a lease as lessor, refused to accept a brewery as a guarantor of the lessee and insisted that the brewery become the lessee. The brewery complied. In a suit by the lessors on the lease, the court denied recovery.[84] The court's theory was that the defendant's officer signed the lease without authority. If, on the facts, the courts deem it inequitable to hold

82. Hall v. Ochs, 34 App. Div. 103, 54 N.Y. Supp. 4 (Sup. Ct. 1898); Holm v. Claus Lipsius Brewing Co., 21 App. Div. 204, 47 N.Y. Supp. 518 (Sup. Ct. 1897). See also Fuld v. Burr Brewing Co., 18 N.Y. Supp. 456 (C.P. 1892).

83. Koehler v. Reinheimer, 26 App. Div. 1, 49 N.Y. Supp. 755 (Sup. Ct. 1898).

84. Filon v. Miller Brewing Co., 15 N.Y. Supp. 57 (Sup. Ct. 1891).

the defendant liable as a guarantor, they have frequently relied on the lack of actual or apparent authority of the officer signing the instrument of guaranty or primary obligation.[85]

Absence of any business relationship between the guarantor and a lessee (primary obligor) will sustain a defense of ultra vires in a suit for rent by the lessor.[86] Consistent with this approach is the availability of the ultra vires defense to an accommodation indorser in a suit by a holder of the instrument with knowledge of the accommodation nature of the guaranty.[87] When, however, a plaintiff was a holder in due course of interest coupons attached to bonds, he prevailed against a defense of ultra vires interposed by a guarantor of punctual payment.[88]

One of the older cases arose in a procedural setting presently provided for in the Model Business Corporation Act section which abolishes the defense of ultra vires but permits the assertion of lack of corporate power in a suit by a corporation against a former officer.[89] Parenthetically, it should be noted that New York is not among the states which have a statute abolishing the defense of ultra vires. In *Holmes, Booth & Haydens v. Willard,*[90] the plaintiff-corporation was a producer of metal products. The defendant was its former treasurer and general manager. Plaintiff, pursuant to a contract, purchased all of *X* corporation's production of carbons. Soon *X* corporation's productive capacity became insufficient for plaintiff's needs. To enable *X* corporation to expand its capacity, the following arrangement was made: defendant, then acting as an officer on behalf of the plaintiff corporation and *X* corporation entered into an agreement whereby *X* corporation gave its note to the plaintiff. The defendant, on behalf of the plaintiff, indorsed the note and the proceeds thereof were forwarded to *X* corporation. The plaintiff, after making good on its obligation as indorser-guarantor, commenced this suit against the

85. See Gause v. Commonwealth Trust Co., 196 N.Y. 134, 89 N.E. 476 (1909); Morris v. Wiener, 65 Misc. 18, 119 N.Y. Supp. 163 (Sup. Ct. 1909); O'Connor v. Bankers Trust Co., 159 Misc. 920, 289 N.Y. Supp. 252 (Sup. Ct. 1936).

86. Morris v. Ernest Wiener Co., 65 Misc. 18, 119 N.Y. Supp. 163 (Sup. Ct. 1909).

87. *Infra* note 96.

88. Frank v. New York, C. & St. L. R.R., 175 Misc. 902, 24 N.Y.S.2d 846 (1940) (decision based on implied power to guarantee for benefit of guarantor). See also Harms Co. v. Leonhard Michel Brewing Co., 228 N.Y. 263, 126 N.E. 705 (1920) (guaranty held enforceable because of close business ties between guarantor and primary obligor); Higgins v. Hocking Valley Ry., 188 App. Div. 684, 177 N.Y. Supp. 444 (Sup. Ct. 1919) (holder of bonds without knowledge of defects recovered against guarantor on grounds of estoppel and equitable principles); Appleton v. Citizens' Cent. Nat'l Bank, 190 N.Y. 417, 83 N.E. 470 (1908) (guaranty enforced on theory of direct benefit and resultant estoppel).

89. ABA-ALI MODEL BUS. CORP. ACT § 6 (1953).

90. 125 N.Y. 75, 25 N.E. 1083 (1890).

defendant, claiming that his action in indorsing the note on behalf of plaintiff corporation was unauthorized and sought recovery of its loss sustained in making payment on its indorser's liability. In affirming a judgment in favor of the defendant, the court conceded that the indorsement was ultra vires but that it was beneficial for and in furtherance of the business purposes of the plaintiff to extend financial aid to a supplier (X corporation). Therefore, since the plaintiff, in the court's opinion, could not have successfully interposed a defense of ultra vires in a suit against it as an indorser-guarantor, the plaintiff could not maintain an action against a former officer based upon his alleged improper exercise of corporate power or capacity.

To date, no reported cases appear to have arisen under the statutes abolishing the defense of ultra vires, permitting of the exceptional assertion by a corporation of the lack of corporate power or capacity in a proceeding against an incumbent or former officer or director. The reasoning of the court in *Holmes, Booth & Haydens v. Willard*[91] is indicative of a possible approach in this type of proceeding.

Another variety of procedural setting occurred in *Anderson v. Title Guar. & Trust Co.*[92] The plaintiff was the owner of a participating certificate in a mortgage issued by the defendant coupled with a guaranty of payment of principal and interest issued by the guaranty company. The plaintiff, claiming that under the charter of the guarantor its power was limited to the guaranty of mortgages issued only on improved and unencumbered land, sued for rescission and a return of monies paid to the defendant. The court, on plaintiff's motion for summary judgment, found for the defendant. Upon an examination of the statutes relating to investments in improved and unencumbered land and the special act under which the guarantor was incorporated, the court held that the company had the power to make the guaranty in question. Special emphasis was placed by the court on the defendant's practice during the past forty years of issuing such guaranties and that by reason thereof, if the defendant were sued thereon, it would be estopped in the face of its conduct over the years from setting up the defense of ultra vires.

Within the scope of the benefit concept, a bank acting as guarantor in aid of a depositor will be held to its promise.[93] However, the

91. *Ibid.*

92. 160 Misc. 881, 290 N.Y. Supp. 508 (Sup. Ct. 1936), *aff'd*, 248 App. Div. 895 (1937), *aff'd*, 274 N.Y. 546, 10 N.E. 544 (1937). *Accord*, Friedman v. Title Guar. & Trust Co., 161 Misc. 88, 290 N.Y. Supp. 505 (Sup. Ct. 1936).

93. American Sur. Co. v. Philippine Nat'l Bank, 245 N.Y. 116, 156 N.E. 634 (1927). See also O'Connor v. Bankers Trust Co., 159 Misc. 920, 289 N.Y. Supp. 252 (Sup. Ct. 1936), *aff'd*, 278 N.Y. 649, 16 N.E.2d 302 (1938) (Dictum: In time of financial crisis, to avoid loss to depositors and stockholders, clearing house banks had power to guarantee). *Cf.* Appleton v. Citizens Cent. Nat'l Bank, 190 N.Y. 417, 83 N.E. 470 (1908).

guaranty by a trust company was frowned upon by the court as too hazardous an undertaking for a business of that kind.[94]

B.

"(b) [W]hen the guaranty is made in connection with the negotiation by such corporation, by sale or otherwise, of an obligation owned by it."

The clear meaning of this provision is implemented by that part of the proviso clause in the statute reading as follows: "provided, that nothing in this section contained shall be deemed to deny, limit or restrict the powers of guaranty or *warranty* possessed by any stock corporation at common law . . . ." (Italics supplied.) In effect, the provision grants to a corporation the necessary power to sell or transfer an asset, whether it be a negotiable instrument, bond or other chose in action, and in connection with such sale or transfer, permits it to warrant the asset so sold or transferred. Accordingly, when a corporation accepts a note in payment of an obligation, there is no question that it has the power to negotiate the note by indorsement and thus assume the obligation of a guarantor.[95] To be distinguished from this situation are the cases in which a holder of a negotiable instrument, with knowledge of the accommodation nature of a corporate indorsement, seeks to recover against the accommodation indorser, in which cases the defense of ultra vires is sustained.[96] The sale of a bond of another corporation, coupled with a warranty of the asset sold, falls within the scope of this provision.[97]

C.

"(c) [W]hen the obligation to be guaranteed is that of another corporation at least a majority of the voting shares of which is at the time owned, directly or indirectly, by the guarantor corporation and when the guaranty is authorized or approved by a resolution of the board of directors of the guarantor corporation."

Two cases, antedating the present statute, show a factual pattern embraced within this provision, *i.e.*, ownership by the guarantor of a majority of the voting stock of the primary obligor and directors' approval of the guaranty.

94. Gause v. Commonwealth Trust Co., 196 N.Y. 134, 89 N.E. 476 (1909).
95. Bank of Genesee v. Patchin Bank, 13 N.Y. 309 (1855).
96. Rosenberg v. Beckenstein, 211 App. Div. 791, 208 N.Y. Supp. 309 (Sup. Ct. 1925); Fox v. Rural Home Co., 90 Hun. 365, 35 N.Y. Supp. 896 (Sup. Ct. 1895), *aff'd*, 157 N.Y. 684, 51 N.E. 1090 (1898); National Park Bank v. German-American Mut. Warehousing & Security Co., 116 N.Y. 281, 22 N.E. 567 (1889). *But see* Approved Factors v. Imperial Bolt & Screw Co., 172 N.Y.S.2d 857 (Sup. Ct. 1958) (recovery by holder in due course against maker of note); National State Bank v. E. B. Metal Products Co., 137 N.Y.S.2d 202 (Sup. Ct. 1954) (recovery by holder against acceptor which had permitted drawer to obtain funds to fulfill its production requirements under contract with defendant).
97. Arnot v. Erie R.R., 67 N.Y. 315 (1876).

In *Nurick v. Baker*,[98] the plaintiff, a minority stockholder, sued directors of the Consolidated Edison Company for damages for losses resulting from the guaranty of payment by the Consolidated Edison Company of bonds issued by the New York Steam Corporation. The guarantor owned ninety-five per cent of the stock of the primary obligor. In dismissing the complaint, with leave to file an amended complaint, the court observed that there had been no improper motives in giving the guaranty, such as special benefits received by the defendants (directors), for approving the guaranty and that the Consolidated Edison Company had the power to act as guarantor. The way in which the case arose is of interest. The proceeding is one of the exceptional instances under the Model Business Corporation Act section abolishing the defense of ultra vires in which lack of corporate capacity or power may be asserted "in a proceeding by the corporation . . . acting . . . through shareholders in a representative suit, against the incumbent or former officers or directors of the corporation."[99]

In *Venner v. New York Cent. & H.R.R.R.*,[100] the plaintiff, a minority stockholder, brought an action against the defendant corporation to restrain it from consummating an agreement whereby the defendant[101] planned to purchase equipment for interrelated railway companies in which the New York Central & H.R.R.R. Co. owned the majority of shares and had controlling interests. Under the agreement, vendors sold equipment to a trust company which issued trust certificates and, under a conditional sales agreement, the trust company rented the equipment to the railroads and, on full payment of "rent," it agreed to convey title to the equipment to the railroads. The plaintiff alleged that the effect of the agreement was to make the New York Central the guarantor of payment for the equipment, and that the agreement was ultra vires because the equipment was not to be delivered to the defendant but to the other railroads. The court held that the transaction was valid and executed in fulfillment of the corporate purposes of the defendant which directly benefitted thereby. The case is of special interest because of the way in which it arose; the proceeding is another one of the exceptional instances under the Model Business Corporation Act section abolishing the defense of ultra vires in which lack of corporate capacity or power may be asserted "in a proceeding by a shareholder against the corporation to enjoin the doing of any act or acts . . . by . . . the corporation."[102]

98. 14 N.Y.S.2d 503 (Supp. Ct. 1939).
99. ABA-ALI MODEL BUS. CORP. ACT § 6 (1953); *cf. supra* note 89.
100. 160 App. Div. 127, 145 N.Y.S. 725 (Sup. Ct. 1914).
101. The complaint against another defendant was dismissed because of plaintiff's failure to prove Michigan law.
102. ABA-ALI MODEL BUS. CORP. ACT § 6 (1953).

D.

"(d) when the guaranty is specifically authorized or approved by the affirmative vote of the holders of at least two-thirds of all the outstanding shares of such corporation entitled to vote thereon . . . or by the written consent, without a meeting, of the holders of all its outstanding shares entitled to vote thereon. . . ."

This provision prescribes a method permitting stockholders to consent and thereby estop themselves from later challenging what might constitute an ultra vires act in the absence of such consent. The reported cases which highlight the effect of stockholders' consent are those involving not the giving of a guaranty but the execution of a mortgage. The plaintiff may seek to foreclose and be met with the defense of ultra vires or he may attempt to set aside the mortgage as having been executed in abuse of corporate power. In such cases, the courts, absent injury to creditors or fraud, will not countenance the plea of ultra vires, either as a defense or a basis for affirmative relief.[103] It would appear from the clear mandate of the statute, that the same reasoning would apply in the case of a corporate guaranty. Noteworthy is the fact that under the statute, estoppel would appear to be operative with the consent (vote) at a meeting of at least two-thirds of the stockholders entitled to vote.

IV. Comment

The foregoing review of the statutes and cases invites an inquiry into considerations of public policy relating to the problem of the corporate guaranty.

A. The Accommodation Indorsement

The harsh impact of the ultra vires defense upon the corporate guaranty is vividly revealed in the accommodation indorsement cases. It is ironic that one who financially aids a business, in reliance upon a corporate indorsement, should frequently be barred from recovery, whereas one who, without knowledge of the "accommodation," discounts the paper (thereby becoming a holder in due course) is not barred from recovery. The fact that the guarantor does not receive the funds advanced by the extender of credit should not be conclusive of the accommodation character of the guaranty. There could be many reasons, due to the demands of a highly competitive economy, which would prompt a corporation to act as an indorser without receiving

103. Zurlin v. Hotel Levitt, Inc., 5 App. Div. 2d 945, 172 N.Y.S.2d 427 (Sup. Ct. 1958) (action to foreclose mortgage); Santos v. National Bank, 130 Misc. 348, 223 N.Y. Supp. 817 (Sup. Ct. 1927) (action to set aside chattel mortgage); Behrman v. Zelman, 130 Misc. 846, 225 N.Y. Supp. 385 (Sup. Ct. 1927) (action to set aside chattel mortgage).

the funds furnished by the extender of credit. It is submitted that judicial reversal of the exercised judgment of directors or corporate officers, actually or apparently authorized, too frequently constitutes a usurpation of the function of the corporate board. To observe that the gap can be closed by stockholders' consent is not a complete solution, for frequently such consent cannot be readily obtained. Facing up to the problem, Georgia, by statute, empowers a corporation "to make any purely accommodation guaranty, indorsement or contract of suretyship . . . ." if the charter so provides.[104] With such a provision contained in the charter, authorized by the statute, a "built-in" stockholders' consent to the grant of the power, in effect, is afforded. This statutory approach, which eliminates uncertainties attending transactions of this kind, appears to be a good solution for a troublesome problem and is recommended as a pattern for other states to follow.

B. Benefit to the Guarantor

What is the business or legal relationship of the corporate guarantor to the primary obligor? Under what set of circumstances will a court view the act of guaranty as causally related to the probable benefit of the guarantor? Such an appraisal problem frequently confronts counsel for the extender of credit. When quick action is required because of the primary obligor's immediate need for funds and stockholders' approval cannot be readily obtained, the situation becomes uneasy for all parties concerned. Often the extender of credit will take the calculated risk to avoid disturbance of good business relations with a customer. It would seem that the law should do better for those who feed funds to the business community or otherwise aid in corporate credit transactions than expect them to rely on principles of estoppel or companion theories evolved by the courts. North Carolina, by statute, has taken cognizance of the problem by granting power to corporations "to enter into contract of guaranty or suretyship or make other financial arrangements for the benefit of its personnel or customers or suppliers."[105] In line with this trend, the Colorado statute confers unqualified power to guarantee the obligations of employees.[106] One court was quite explicit in according recognition to business custom:[107] In holding the guarantor liable on a building contractor's surety bond, the court took judicial notice of the custom then prevailing on Puget Sound which made it necessary

104. GA. CODE ANN., § 22-1828(c) (Supp. 1958).
105. N.C. GEN. STAT. § 55-17(b)(3) (Supp. 1959).
106. COLO. REV. STAT. ANN. § 31-27-4 (Supp. 1959).
107. Wheeler, Osgood & Co. v. Everett Land Co., 14 Wash. 630, 45 Pac. 316 (1896).

for a lumber corporation to guarantee the bonds of contractors in order to obtain their business because non-corporate lumber companies engaged in that practice. Implicit in the court's decision and rationale was the thought that stockholders and creditors of the corporate guarantor eventually stand to gain if the corporation is allowed wide latitude in contending with competitive business conditions. The realistic attitude reflected in the North Carolina and Colorado statutes and by the Washington court comports with the modern tendency in the law to recognize as germane to doing business a corporation's varied relations and activities often seemingly unrelated to making a profit. The old notion that the enforceability of a corporate guaranty must depend upon the realization of an immediate benefit can find new direction in recent developments in the field of federal taxation. Examples of the broadening of the base of proper corporate business activity are the limited deductions for pension and profit sharing plans,[108] the granting of restricted stock options to employees,[109] gift payments to the family of a deceased employee,[110] and fringe benefits such as group insurance. This policy of the law which sanctions "give aways" of corporate assets, intended as incentives for the better conduct of corporate business, has received judicial approval.[111] It is submitted that the courts, in passing upon the enforceability of a corporate guaranty, should take a similar view in giving recognition to the essential business motivations which inhere in the relationships among extenders of credit, primary obligors and corporate guarantors. By the same token, the state legislatures, in future statutory revisions, should view the North Carolina and Colorado statutes as helpful examples of accommodating the scope of the corporate guaranty to the specific and practical needs of the business community.

C. Statutes Granting the Power to Guarantee

Always present in the problems attending the corporate guaranty, regardless of the existence in a given state of a statute empowering a

108. INT. REV. CODE OF 1954, § 404.
109. INT. REV. CODE OF 1954, § 421.
110. See Fifth Avenue Coach, Inc., 31 T.C. 111 (1959).
111. A revealing and related illustration is represented by the group of cases dealing with the sale and exchange of property ordinarily resulting in a capital gain or loss. When, however, the sale or exchange is inextricably bound up with the corporate business, the loss resulting from the sale or exchange will be considered an ordinary as distinguished from a capital loss and therefore fully deductible. For example: Corporation A, in order to obtain a supply of raw materials, is required by the supplier to buy its debenture bonds. The bonds are subsequently disposed of at a loss. Although normally the loss would be capital in nature, under the facts, the loss would be ordinary in nature because the purchase of the bonds was an integral part of the procurement of the supplies. See Western Wine & Liquor Co., 18 T.C. 1090 (1952); REV. RUL. 58-40, 1958-1, CUM. BULL. 275.

corporation to guarantee, are the rights of the intra vires creditors of the guarantor. Consideration of this phase of the study is hereinafter separately treated.[112]

We observed that in the twenty-six states[113] with statutes specifically empowering a corporation to act as a guarantor, the old line cases are similar in rationale and result to the cases decided by the courts in the states which are without benefit of such a statute. In twenty of these states,[114] the statute is worded either precisely or substantially in terms of a bald grant of the power to guarantee. A statute so phrased is considered to be declaratory of the common law of the state and therefore is no better guide than the complex of the cases previously decided.[115] In the small balance of the states, the statutes reflect a mixture of legislative restriction and slight relaxation.[116] The measure of relaxation has been mentioned in commenting on the statutes in Georgia,[117] North Carolina,[118] and Colorado.[119]

The amendment of the New York statute in 1944[120] was basically a codification of the common law of the state. The first of the fourfold specified categories[121] of grants of power, requiring that the guaranty must be made in connection with, and incidental to, the exercise by the corporation of its corporate "rights, powers, purposes, privileges and franchises," is a statutory formulation of the tests which have been prescribed by the courts in conformity with the concept of benefit to the guarantor. The second category empowering a corporation to guarantee in connection with the negotiation of an obligation owned by it is statutory recognition of decided case law. The third category which empowers a corporation to guarantee an obligation of a subsidiary upon authorization or approval of the board of directors in effect prescribes the implementing procedure for a power generally recognized by the courts of nearly all states. Thus, the second and third categories aside, counsel must depend for guidance upon court decisions or rely upon the procedure set forth in the fourth category. The fourth category sanctions any guaranty of an "obligation for the payment of money" if it is authorized or approved by a two-thirds vote of all outstanding shares entitled to vote or by the written consent of all of the outstanding shares entitled to vote.

112. See pages 259 to 260 *infra*.
113. *Supra* note 31.
114. *Supra* notes 32 and 33.
115. 33 MICH. L. REV. 94, 96 (1934). See 13 FORDHAM L. REV. 233, 237 (1944).
116. *Supra* notes 34 through 40.
117. *Supra* note 104.
118. *Supra* note 105.
119. *Supra* note 106.
120. N.Y. STOCK CORP. LAW § 19.
121. *Supra* note 80.

It is the fourth category on which counsel generally relies rather than risk the uncertainties of predicting how a court will react to a factual situation in the absence of stockholders' approval. Read literally, the statute appears to grant a power of guaranty, subject to approval at a meeting of at least two-thirds of the stockholders entitled to vote, without qualification or requirement of conformity to the standard of benefit to the guarantor. To date, the New York courts have not passed precisely upon this aspect of the statute.[122] It is submitted that the desirability of certainty in corporate credit transactions should compel a literal interpretation of the statute, and that in the rare instances of the making of grossly imprudent guaranties the stockholders and the corporation should seek recourse against directors and officers.[123] Also, the New York legislature should enact a statute abolishing the defense of ultra vires patterned after the provisions of the applicable section of the Model Business Corporation Act.[124]

It would appear that the statutes specifically granting the power to guarantee have not, to date, contributed substantially toward a liberalization of the court-made rules applicable thereto. Court reaction has been slow: in only two reported cases[125] have the courts interpreted the broadly worded statutes as an enlargement of the power to guarantee rather than a codification of the common law.

Certain provisions and characteristics of the statutes specifically granting the power to guarantee together with related statutes may have a bearing upon the interpretation the courts will give to the statutes abolishing the defense of ultra vires. They indicate that side by side with the new legislation are statutory vestiges of adherence to converse thinking. For example, of the twenty-six states with statutes empowering a corporation to guarantee, the statutes in seventeen of the states[126] limit the power to the obligations of another corporation, making no mention of the power to guarantee the obligations of individuals and unincorporated associations. This seeming

122. See Rusch & Co. v. Syndicate First Corp., 7 Misc. 2d 198, 155 N.Y.S.2d 369 (Sup. Ct. 1956).

123. See 13 FORDHAM L. REV. 233, 237 (1944), where the author comments on the 1944 amendment to the New York statute: "Would the courts countenance a pledge of credit in an instance where the president of a corporation, in control of two-thirds of the voting shares, guaranteed in the name of the corporation the payment of jewelry purchased by his wife? Judicial conservativeness may well refuse to recognize such a liberal use of the corporate power to guarantee even though the literal interpretation of the amended statute might permit such non-corporate use."

124. *Supra* note 43.

125. *Supra* notes 55 and 71.

126. See *supra* note 31 for statutory references to Delaware, Florida, Idaho, Indiana, Kansas, Louisiana, Michigan, Minnesota, Mississippi, Nevada, New Mexico, Pennsylvania, Rhode Island, Tennessee, Virginia, Washington, and West Virginia.

oddity has a history: the forerunner of the corporate guaranty statutes empowered a corporation to own stock or bonds in another corporation, coupled sometimes (as in New York) with the requirement that the other corporation be engaged in the same general line of business. This latter requirement was apparently imposed with two thoughts in mind: first, the other corporation, being a corporation and not an individual or unincorporated association, had limited powers and, second, having such limited powers, ownership of stock and bonds in the other corporation, by reason of its being engaged in the same general line of business, minimized the risk entailed in exposing part of the corporate capital to the risks of the other business. Consistent with such legislative wariness, the privilege of investment was then sparingly extended to permit, within prescribed limits, of the power to guarantee the stock and bonds of the other corporation. Even today, in some states, the provision empowering a corporation to guarantee is contained in the same statute empowering a corporation to own stock and bonds in another corporation.[127] In fact, New York, by statute, still prescribes as a condition of owning stock in another corporation that the other corporation be engaged in a similar business or that the certificate of incorporation contain an authorizing provision.[128] In keeping with this protective attitude toward stockholders' interests and creditors' rights, some states by decisional law prohibit a corporation from becoming a member of a partnership lest the corporate assets be dissipated in satisfying claims of partnership creditors. Indicative of the contrary trend, consistent with recoguition of the need for calculated business risks, are statutes in four states which empower a corporation to become a member of a partnership.[129]

D. Statutes Abolishing the Defense of Ultra Vires and Interrelated Problems

This type of statute, in relation to the corporate guaranty, has been reviewed by the courts in only two reported cases.[130] In both instances, the courts interpreted the statute as a legislative mandate that the ultra vires defense shall not be entertained in a suit on a corporate guaranty. The meager case history, to date, does not justify the assumption that the old dogma of benefit to the guarantor, estoppel, and companion theories will no longer be applied by the

127. MINN. STAT. ANN., § 301.10 (1947); N.M. STAT. ANN. § 21 (1953); WASH. REV. CODE § 23.01.120 (1958).

128. N.Y. STOCK CORP. LAW § 18.

129. Alaska Sess. Laws 1957, ch. 126, § 4; COLO. REV. STAT. ANN. § 31-27-4 (Supp. 1959); N.C. GEN. STAT. § 55-17 (Supp. 1959); VA. CODE ANN. § 13.1-3 (1950).

130. *Supra* note 60.

courts. Notwithstanding the categorical directive in the statutes, when the new legislation was first enacted, one commentator said:

> But it is doubtful if even the broader type of statutes will radically change the common law. *In an extreme case, in which a plaintiff with knowledge seeks to enforce a contract involving little or no possibility of benefit to the corporation, the courts are almost certain to take advantage of the slightest loophole in the statute in order to bar him from recovery;* and after all, it is only in this type of case that they have, in the absence of statute, reached this result. That this will be the judicial attitude is strongly suggested by one case which has arisen under one of the new statutes.[131] (Italics supplied.)

The heart of the problem is whether a court, in the face of the statute, will decide against the enforceability of the guaranty because of "no possibility of benefit to the corporation." It is submitted that the factor of benefit to the guarantor should be resolved by the courts in terms of a conclusive presumption. That presumption would operate to render absolute from the standpoint of "benefit" a corporation's determination, acting by its directors or agents with actual or apparent authority, to act as a guarantor. The only grounds of challenge should be the authority of a corporate agent to bind the corporation to the guaranty, and with respect to that issue the rules of agency will apply.[132]

The factor of the plaintiff's actual knowledge of the corporation's lack of capacity or power to make the guaranty is differently treated by the states which have enacted the new legislation. In some states such actual knowledge will bar recovery.[133] A contrary view is represented by the states which have adopted the Model Business Corporation Act version of the statute.[134] In this connection, care should be taken to distinguish between actual knowledge of a corporate agent's lack of actual or apparent authority to make the contract of guaranty and actual knowledge of the corporation's lack of power or capacity to make such contract. In the former case, as

131. Note 83 U. PA. L. REV. 479, 498-99 (1935). The author cites Wardowski v. Guardian Trust Co., 262 Mich. 422, 247 N.W. 908 (1933) (dictum on ultra vires aspects not related to the corporate guaranty).

132. See Ballantine, *Proposed Revision of the Ultra Vires Doctrine*, 12 CORNELL L.Q. 453, 458 (1927); Stevens, *A Proposal as to the Codification and Restatement of the Ultra Vires Doctrine*, 36 YALE L.J. 297, 335 (1927).

133. KAN. GEN. STAT. § 17-4101 (1949); MICH. STAT. ANN. § 21.11 (1937); MINN. STAT. ANN. § 301.12 (1947). Some significance may attach to the fact that the Kansas and Minnesota statutes refer to a third person's actual knowledge of a corporation's lack of "authority" as distinguished from power or capacity, whereas the Michigan statute refers to the third person's actual knowledge of the "ultra vires character of the act." See also Navarro, *Ultra Vires Reform*, 25 PHILIPPINE L.J. 637 (1950).

134. *Supra* note 44. See also CAL. CORP. CODE ANN. § 803 (West 1956); OHIO REV. CODE ANN. § 1701.13(H) (Baldwin 1958); PA. STAT. ANN. tit. 15, § 2852-303 (1958).

hereinabove indicated,[135] the rules of the law of agency should govern. In the latter case, to permit inquiries as to actual knowledge is an invitation to litigation involving issues of fact comparable to those which have arisen in the application of the doctrine of benefit to the guarantor, and there is the risk that we shall come full circle with cases again decided on the facts in tribute to the unpredictable estoppel techniques. It is submitted that, in the interests of standards of certainty in business transactions, the door should be closed to inquiries of knowledge as to a corporation's power or capacity to make the contract of guaranty.

Related to the elimination of the doctrine of limited corporate capacity is the elimination of the doctrine of constructive notice. Kansas has provided specific statutory coverage: "and no person dealing with the corporation shall be charged with constructive notice of the contents of the articles of incorporation, merely from the fact that such articles of incorporation have been filed or recorded."[136] Such a statutory provision relieves a party contracting with a corporation from being charged with knowing, at his peril, whether a court will agree with him that the contemplated contract is within its power,[137] and is a logical supplement to a statute abolishing the defense of ultra vires. This type of statute should be more widely enacted.

Problems of statutory construction can be anticipated. For example, in its typical guaranty statute, North Carolina specifically empowers a corporation to make guaranties for the benefit of its "personnel or customers or suppliers."[138] North Carolina also has a statute abolishing the defense of ultra vires.[139] Will the courts of that state, in passing upon the effect of the latter type statute, view it as applicable only to the specified primary obligors? It is submitted that when a typical guaranty statute specifies certain primary obligors, such specification is intended for emphasis and not for exclusion and that the statute abolishing the defense of ultra vires should be pervasive and generally applicable.

The traditional protective attitude of the courts toward stockholders and creditors of the corporate guarantor will be important factors in the interpretation of the new legislation. Basic to this problem is the courts' concern that stockholders' investments and creditors' interests should not be exposed to uncontrolled risks. It is submitted that from the standpoint of business realities the corporate guarantor's risk should be viewed not as uncontrolled but as calculated.

135. *Supra* note 132.
136. KAN. GEN. STAT. § 17-4101 (1949).
137. Carpenter, *Should the Doctrine of Ultra Vires Be Discarded*, 33 YALE L.J. 49, 62 (1923).
138. N.C. Gen. Stat. § 55-17 (Supp. 1959).
139. *Id.* at § 55-18.

As to stockholders, the new legislation is explicit in affording them the remedy of injunction and the right to institute a representative suit.[140] Those remedies do not exist by legislative grace of the new statutes, but provision therefore represents a codification of the common law.[141] How the stockholder will fare before the courts under the statutes remains to be seen. It is possible that a court will take the position that, with respect to a stockholder, the following ultra vires rule will apply: "Where the contract has been fully executed by the plaintiff, and benefits have been conferred on the defendant, the defendant cannot plead ultra vires and escape liability."[142] If, in applying that rule, the courts will credit a conclusive presumption of benefit to the guarantor, and assuming what is the invariable fact, *i. e.*, full performance by the extender of credit, the latter should prevail if the stockholder should seek to enjoin.[143] On equitable principles alone, it would seem that the risk of directors' and corporate agents' mistakes of judgment should fall upon the stockholders who have entrusted the management and conduct of corporate affairs to the directors and agents.

As to the intra vires creditors, the new legislation is silent, and resort must be had to decisional law. In their statements of rule and policy, the courts have been emphatic in holding that the intra vires creditors will prevail as against the extender of credit in reliance upon a corporate guaranty.[144] The fact that all stockholders consent will not affect the application of the rule.[145] When, however, the contract of guaranty is held enforceable, the rule will not apply.[146] Such a judicial attitude does not take into account the equities involved among the parties. Important to bear in mind is the fact that the extender of credit, in reliance upon a corporate guaranty, frequently enters upon the business scene when the financial position of the primary obligor is precarious. His contribution of financial or other aid to the primary obligor is a multiple assist, extending to the guarantor, its intra vires creditors and stockholders as well as the creditors and stockholders of the primary obligor. Also, such extender of credit does not seek a preference over the guarantor's intra vires

140. ABA-ALI MODEL BUS. CORP. ACT § 6 (1953). See also *supra* note 44.
141. Stevens, *supra* note 132, at 335.
142. Kefauver, *The Doctrine of Ultra Vires*, 6 TENN. L. REV. 20, 31 (1927).
143. See Barton and Ruart, *A Relaxed Approach to the Problem of Ultra Vires*, 34 U. DET. L.J. 297, 301 (1957).
144. *In re* Marblehead Land Co., 96 F.2d 72 (9th Cir. 1938); *In re* Gilchrist Co., 278 Fed. 235 (D. Mass. 1922). *Cf.* Zurlin v. Hotel Levitt, Inc., 5 App. Div. 2d 945, 172 N.Y.S. 427 (3d Dep't 1958); Behrman v. Zelman, 130 Misc. 846, 225 N.Y. Supp. 385 (Sup. Ct. 1927); Santos v. Nat'l Bank, 130 Misc. 348, 223 N.Y. Supp. 817 (Sup. Ct. 1927).
145. Thomas v. E. G. Curtis Sons Co., 7 F. Supp. 114 (E.D. Mich. 1934); *In re* Prospect Worsted Mills, 126 Fed. 1011 (D. Mass. 1904); Simmons Nat'l Bank v. Dilley Foundry Co., 95 Ark. 368, 130 S.W. 162 (1910).
146. Wasson v. American Can Co., 189 Ark. 354, 72 S.W.2d 241 (1934).

creditors. He seeks only to participate pro rata. There is authority for the view that the intra vires creditor's remedy is by action based on fraud and that his rights do not rest upon the doctrine of ultra vires.[147] It is submitted that in the absence of actual knowledge of a corporate agent's lack of actual or apparent authority to make a contract of guaranty, such extender of credit should share pro rata with intra vires creditors in consequence of the application of the recommended rule that the new legislation is equivalent to a statutory mandate of a conclusive presumption of benefit to the guarantor.

It is hoped that the courts will continue to interpret the new legislation in the remedial spirit with which it was enacted. If they do, there will be a considerably increased element of certainty in business transactions in which the corporate guaranty as a credit device is employed. The substitution of precisely predictable rules for the enigma of estoppel and the anachronistic doctrine of ultra vires will have a salutary effect upon the business community. It is possible, too, that the new legislation will have a deterrent effect upon litigation relating to the enforceability of the corporate guaranty.

147. Stevens, *supra* note 132, at 315; Carpenter, *supra* note 137, at 65.