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Banks and Banking--Duties and Liabilities of a Director

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RECENT CASE COMMENTS

BANKS AND BANKING — DUTIES AND LIABILITIES OF A DIRECTOR. — The receiver of a national bank sued a director on a note given for eighty shares of stock in the bank, which the director had been induced to purchase by the false representations of the bank's president. These false representations of the president would have been discovered by the director if he had examined certain reports which were submitted to the board of directors, and the director actually knew of the falseness of the representations before the bank closed, but he made no attempt to rescind the purchase until some time after the bank closed. He now sets up a counter-claim based on a rescission of the purchase because of the false representations. *Held,* that assuming everything else in the director's favor, the fact that he was a director prevented his recovery on this counter-claim. It was his duty as a director to examine the books of the bank, and had he done so he would have learned of the falseness of the representations. Judgment for the receiver. *Goess v. Ehret.*[1]

The director was under a duty imposed both by statute[2] and by common law[3] to participate in the management of the bank, and he could not properly leave the affairs in the hands of its president. However, this director is not attempting to escape liability for a neglect of his duty, but is attempting to recover for a fraud perpetrated on him because of his failure to perform his duty. This feature makes the case unique, and probably without precedent.

The determination of the case seems to depend on the view that is taken as to the director's negligence preventing his having any relief as against an intentional tort, *i. e.,* fraud. While there is authority to the effect that one having access to the facts should avail himself of the opportunity to investigate,[4] the better view would seem to be that his failure to investigate should not bar his right to recover for an intentional wrong.[5] Granted that directors

[1] 85 F. (2d) 109 (C. C. A. 2d, 1936).

[2] 43 STAT. 955 (1925), 12 U. S. C. A. § 73 (1936).

[3] Bowerman v. Hamner, 250 U. S. 504, 39 S. Ct. 549 (1919); Gamble v. Brown, 29 F. (2d) 366 (C. C. A. 4th, 1928); *cert. denied,* 279 U. S. 839, 49 S. Ct. 253 (1929); Hughes v. Reed, 46 F. (2d) 435 (C. C. A. 10th, 1931).

[4] Slaughter's Adm'r v. Gerson, 13 Wall. 379, 20 L. Ed. 627 (U. S. 1872); Farnsworth v. Duffner, 142 U. S. 43, 47, 12 S. Ct. 164 (1891); Crislip v. Cain, 19 W. Va. 438, 464 (1882); Hallidie v. First Federal Trust Co., 177 Cal. 600, 604, 171 Pac. 431, 432 (1918); Roosevelt v. Missouri State Life Ins. Co., 78 F. (2d) 752 (C. C. A. 8th, 1935).

[5] Wilson v. Higbee, 62 Fed. 723 (C. C. Nev. 1894); Cottrill v. Crum, 100 Mo. 397, 13 S. W. 753 (1890); Wilson v. Carpenter, 91 Va. 183, 21 S. E. 243 (1895); Bowe v. Gage, 127 Wis. 245, 106 N. W. 1074 (1906); Western Mfg.

owe a duty to investigate corporate affairs, does this duty run to the whole world, or merely to the corporation, its stockholders and creditors? The general view seems to be that the duty runs only to the corporate creditors[6] and to the corporation and its stockholders.[7] If the duty runs to the whole world, then indeed may you have "negligence in the air".[8] This is the first case which holds the director's duty an all inclusive one, and which has the effect of making the director act at his peril. While the case says that it does not charge the director with notice of all the corporate books contain, as does the case of *Briggs v. Spaulding*,[9] yet it does charge him with knowledge of the contents of the reports which show the financial condition of the bank.

There are at least two other grounds on which the case might possibly have been decided. The district court based its decision on the fact that a national bank is not permitted to deal with its own stock, and that a person dealing with it has no recourse for any loss suffered.[10] It is also conceivable that laches might have barred the director from setting up his counter-claim. He had actual notice of the fraud six months before the bank closed, and some time passed after the bank closed before he made any attempt to rescind the purchase; therefore, under the circumstances of the case, laches might easily have been the basis for the decision. The fact that fraud was originally the basis for equitable relief, and the fact that the court might consider this director as not having "clean hands", probably had some influence with the court in making their decision.[11] However, the result of the case seems to be correct,

Co. v. Cotton & Long, 126 Ky. 749, 104 S. W. 758 (1907), 12 L. R. A. (N. S.) 427 (1908). See HARPER, LAW OF TORTS (1933) §§ 150, 224. Staker v. Reese, 82 W. Va. 764, 97 S. E. 641 (1918) and Stout v. Martin and Edgell, 87 W. Va. 1, 104 S. E. 157 (1920) *semble* are *contra* to Crislip v. Cain, 19 W. Va. 438, *supra* n. 4, inasmuch as they hold that a person has a right to rely on representation without making inquiry to determine its truth.

[6] McCourt v. Singers-Bigger, 145 Fed. 103 (C. C. A. 8th, 1906); Elliott v. Farmers' Bank, 61 W. Va. 641, 57 S. E. 242 (1907); Hibernia Bank v. Cincienne, 140 La. 969, 74 So. 267, L. R. A. 1917D 402 (1917).

[7] Jackson v. Ludeling, 21 Wall. 616, 22 L. Ed. 492 (U. S. 1874); Buchler v. Black, 226 Fed. 703 (C. C. A. 9th, 1915); Hoyle v. Plattsburgh R. Co., 54 N. Y. 315, 328 (1873); Hope v. Valley City Salt Co., 25 W. Va. 789 (1884).

[8] Palsgraf v. Long Island Ry. Co., 248 N. Y. 339, 341, 162 N. E. 99 (1928). In this case Justice Cardozo says, "Proof of negligence in the air, so to speak, will not do."

[9] Briggs v. Spaulding, 141 U. S. 132, 162, 163, 11 S. Ct. 924 (1890).

[10] Goess v. Ehret, 13 F. Supp. 630 (S. D. N. Y. 1936).

[11] Strictly speaking, the "clean hands" doctrine probably would not apply, since the fraud and the director's "unclean hands" are not involved in the same transaction.

since it tends to discourage dummy directors or directors who are lax in attending to corporate affairs.

J. E. C.

CONSTITUTIONAL LAW — MUNICIPAL CORPORATIONS — CONSTITUTIONALITY OF ACT EXTENDING BANKRUPTCY ACT TO COVER POLITICAL SUBDIVISIONS OF STATES. — Petitioner, an irrigation district organized under the laws of Texas,[1] presented a petition to the District Court in accordance with the Sumners Act,[2] amending the Bankruptcy Act[3] to provide for the relief of insolvent political subdivisions of states by a readjustment of their obligations. The Act provided that a plan of readjustment should be put in force if (1) the state consented, (2) two-thirds of the creditors should agree to the plan, and (3) the district judge should consider the plan to be a fair one. The state had consented;[4] thirty per cent of the creditors had consented, and it was believed that the requisite two-thirds would consent; but the district court dismissed the petition on the ground *inter alia,* that the Sumners Act was unconstitutional.[5] This decree was reversed in the circuit court of appeals,[6] and the Supreme Court granted *certiorari. Held,* that the Act was unconstitutional in that it impaired state sovereignty. Four justices dissented. Petition for a rehearing denied.[7] *Ashton v. Cameron County Water Improvement District No.* 1.[8]

The theory of the majority of the Court was that since it was well established that the federal government and the governments of the several states were each immune from taxation by the other,[9]

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[1] TEX. COMP. STAT. (Vernon, 1928) §§ 7622-7807.

[2] 48 STAT. 798 (1934), 11 U. S. C. A. §§ 301-303 (Supp. 1934).

[3] 30 STAT. 544 (1898), 11 U. S. C. A. § 1 *et seq.* (1927).

[4] Tex. Laws 1935, c. 107.

[5] *In re* Cameron County Water Improvement Dist. No. 1, 9 F. Supp. 103 (1934).

[6] Cameron County Water Improvement Dist. No. 1 v. Ashton, 81 F. (2d) 905 (1936).

[7] (1936) 4 U. S. L. WEEK 146.

[8] 56 S. Ct. 892, 80 L. Ed. 910 (1936).

[9] McCulloch v. Maryland, 4 Wheat. 316, 4 L. Ed. 579 (U. S. 1819); Weston v. Charleston, 2 Pet. 449, 7 L. Ed. 481 (U. S. 1829); Collector v. Day, 11 Wall. 113, 20 L. Ed. 122 (U. S. 1870); United States v. Railroad Co., 17 Wall. 322, 21 L. Ed. 597 (U. S. 1873); Mercantile National Bank v. New York, 121 U. S. 138, 7 S. Ct. 826 (1887); Pollock v. Farmers' Loan & Trust Co., 157 U. S. 429, 15 S. Ct. 673, 158 U. S. 601, 15 S. Ct. 912 (1895); Ambrosini v. United States, 187 U. S. 1, 23 S. Ct. 1 (1902); Indian Motocycle Co. v. United States, 283 U. S. 570, 51 S. Ct. 601 (1931); Burnet v. Coronado Oil & Gas Co., 285 U. S. 393, 52 S. Ct. 443 (1932).