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Inc., ____ Minn. ____, 239 N.W.2d 216 (1976)

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as direct damages, while crop losses and tilling costs arose as a proximate result of the breach and were validly disclaimed consequential damages.³⁴ This determination seems correct, but *Kleven* does indicate that the theoretically simple distinction between direct and consequential damages often can be difficult to apply in practice.³⁵ The hazy distinction between the two types of damages does leave the court with some flexibility, however, especially when a valid disclaimer of consequential damages is involved. By categorizing a loss as being a direct result of the breach, when it is arguably direct or consequential, the court can allow the plaintiff additional recovery despite the disclaimer. This flexibility may be useful to the court as a tool for balancing the equities of the parties in disclaimer cases where the unconscionability doctrine is not applicable.

Corporations—FIDUCIARY DUTY TO CREDITORS—*Swanson v. Tomlinson Lumber Mills, Inc.*, ___ Minn. ___, 239 N.W.2d 216 (1976).

In the recent case of *Swanson v. Tomlinson Lumber Mills, Inc.*,¹ the Minnesota Supreme Court expanded the common law rule that preferences are voidable when given to a director of an insolvent corporation to the detriment of corporate creditors.² Defendant Tomlinson was president and a director of several corporations, including Tomlinson Lumber Sales (Tomlinson Sales). He was also either the sole shareholder or joint owner with members of his family of each of the corporations.

As president of Tomlinson Sales, Tomlinson executed promissory notes totalling \$209,126.26 to Burlington Northern, Inc. (Burlington), payable December 31, 1970. The notes were not paid when due and Burlington commenced suit on the notes on March 5, 1971. At that time, the assets of Tomlinson Sales were composed almost entirely of accounts receivable due from Tomlinson's other corporations. Tomlinson Sales therefore was a creditor of the other Tomlinson corporations. For no consideration, the current accounts receivable were converted by Tom-

34. 303 Minn. at 327, 227 N.W.2d at 571.

35. A comparison of two Minnesota cases suggests that the Minnesota Supreme Court does not rely on formulas or strict definitions but responds to the particular circumstances of each case by designing the damage recovery to meet the buyer's losses. In *Barthelemy v. Foley Elevator Co.*, 141 Minn. 423, 170 N.W. 513 (1919), direct damages (difference between the value of the goods as accepted and the value of the goods if they had been as warranted) were awarded for the failure of seed wheat to mature properly. However, in *Moorehead v. Minneapolis Seed Co.*, 139 Minn. 11, 165 N.W. 484 (1917), the court determined the damages where seed wheat entirely failed to germinate by using a more complex computation involving the value of the land's use with additions (cost of seed and planting) and deductions (value of the use remaining at the time the seed failed to germinate).

1. ___ Minn. ___, 239 N.W.2d 216 (1976).

2. See generally 15A W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS §§ 7467-80 (rev. perm. ed. 1967).

linson into ten-year notes on September 10, 1971, for the admitted purpose of affording the other Tomlinson corporations additional time to arrange their financing and thereby avoid financial ruin.³

The action by Burlington was settled, judgment was entered for Burlington, the execution was returned unsatisfied, and, on May 25, 1972, a receiver, Swanson, was appointed.⁴ The receiver commenced actions against the three other Tomlinson corporations indebted to Tomlinson Sales to liquidate the assets of Tomlinson Sales and satisfy the Burlington judgment.⁵ The conversion of the current accounts receivable was discovered by the receiver in answers to interrogatories, and he moved for summary judgment to set aside the conversion on grounds that it was invalid because Tomlinson exercised common control over the corporations involved.

The Minnesota Supreme Court affirmed the district court's finding that Tomlinson, as president and director of Tomlinson Sales, had breached his fiduciary duty to the creditors of Tomlinson Sales by converting the accounts and rendering the corporation unable to pay its creditors.⁶ Following prior Minnesota case law,⁷ the court restated the principle that directors and officers of an insolvent corporation, with or without fraudulent intent, cannot grant a preference to themselves at the expense of corporate creditors solely because of their relationship to

3. ___ Minn. at ___, 239 N.W.2d at 218. Tomlinson in an affidavit admitted the purpose of the transaction was to afford the other Tomlinson corporations additional time to pay their debts to Tomlinson Sales, thereby necessarily delaying payment to the creditors of Tomlinson Sales. *Id.*

4. MINN. STAT. § 316.05 (1976) provides for appointment of a receiver by the court when a party has obtained a judgment against a corporation and the execution of the judgment is returned unsatisfied.

5. The receiver in *Tomlinson* also sought to recover his own expenses. After the lower court held against Tomlinson, the Burlington judgment was satisfied by Tomlinson. The receiver, however, continued to serve as receiver after the Burlington judgment was satisfied, for the sole purpose of collecting his costs and fees. Tomlinson argued that Swanson had no authority to maintain the action after the Burlington debt was paid. The court held the action could be maintained, stressing that under MINN. STAT. § 316.05 (1976) the costs and expenses of the receiver were to be paid before claims of creditors and that the receiver is an officer of the court and therefore the court has a duty to see that the receiver is paid. *See* ___ Minn. at ___, 239 N.W.2d at 218-20.

6. *Id.* at ___, 239 N.W.2d at 220. Concerning the duty owed by corporate officers and directors to corporate creditors, the court observed:

The relationship between corporate officers and directors and the creditors of a corporation is not altogether clear. While it is said that corporate officers and directors are not trustees for corporate creditors and owe them no fiduciary duty [citation omitted], it appears that this statement is subject to the qualification that there be sufficient assets to pay their claims.

Id.

7. *See Farmers Coop. Ass'n v. Kotz*, 222 Minn. 153, 23 N.W.2d 576 (1946); *Taylor v. Fanning*, 87 Minn. 52, 91 N.W. 269 (1902); *Taylor v. Mitchell*, 80 Minn. 492, 83 N.W. 418 (1900).

the insolvent corporation. In *Tomlinson*, the transfer worked to the detriment of Burlington by rendering Tomlinson Sales unable to pay the note to Burlington or satisfy the subsequent judgment. While the benefit to Tomlinson was indirect, the preferential transfer was for the direct benefit of his other corporations and therefore also was for his benefit.

Although the *Tomlinson* court relied on well-established Minnesota precedent, the case is unique because the precedent relied upon is designed to apply in situations where a director of a corporation also is a corporate creditor and the director secures payment of his debt ahead of the debts of other corporate creditors.⁸ In *Tomlinson*, however, neither Tomlinson nor his other corporations were creditors of Tomlinson Sales, but rather Tomlinson Sales was the creditor. Therefore, the court's ruling seems to stand for the proposition that a transfer creating an indirect benefit to a director, not necessarily a preference over general creditors, may be invalidated where it works to the detriment of the corporate creditors.⁹

In most jurisdictions, absent state statutes¹⁰ or federal bankruptcy proceedings,¹¹ an insolvent corporation can prefer one creditor to the detriment of others.¹² An exception to this rule, however, is where a director who is also a corporate general creditor prefers his pre-existing debt over those of the other general creditors of the insolvent corpora-

8. See note 2 *supra*. In each Minnesota case prior to *Tomlinson*, the court in applying the common-law rule against preferences to corporate directors has done so where an insolvent corporation was the debtor and the director or officer who received the preference was a creditor who received a preference for an antecedent debt. See *Farmers Coop. Ass'n v. Kotz*, 222 Minn. 153, 23 N.W.2d 576 (1946) (chattel mortgage given to former officer-director); *Aiken v. Timm*, 147 Minn. 317, 180 N.W. 234 (1920) (conveyance of all real and personal property of corporation to officer's wife for debt owed to both); *Taylor v. Fanning*, 87 Minn. 52, 91 N.W. 269 (1902) (judgment obtained by nominee of directors to whom the notes evidencing the indebtedness had been assigned); *Taylor v. Mitchell*, 80 Minn. 492, 83 N.W. 418 (1900) (mortgage executed, on behalf of corporation, to board of directors as individuals, each of whom was creditor of corporation).

9. This rule presumably is still subject to some exceptions, such as where a corporate director is given a security interest in exchange for a contemporaneous loan to the corporation. See, e.g., *Taylor v. Mitchell*, 80 Minn. 492, 83 N.W. 418 (1900) (court stressed that rule against preferences was applicable when preference was for pre-existing debt owed by corporation to director).

10. See MINN. STAT. § 60B.32 (1976) (makes certain preferences given by insolvent insurance companies voidable). For a compilation of federal and state statutes affecting the common-law ability to prefer creditors, see 15A W. FLETCHER, *supra* note 2, at §§ 7437-66.

11. See BANKRUPTCY ACT § 60, 11 U.S.C. § 96 (1970) (certain preferences given within four months of filing of bankruptcy are voidable by trustee).

12. See, e.g., *Farmers Coop. Ass'n v. Kotz*, 222 Minn. 153, 23 N.W.2d 576 (1946); 15A W. FLETCHER, *supra* note 2, at § 7421. But see *Furber v. Williams-Flower Co.*, 21 S.D. 228, 111 N.W. 548 (1907) (those courts adhering to "trust fund" doctrine may reach different result).

tion.¹³ Some courts have premised this exception on the "trust fund" doctrine, which basically provides that assets of an insolvent corporation are held in trust for the benefit of its creditors, and that consequently creditors, including director-general creditors, must share pro-rata the corporate assets with the other general creditors of the corporation.¹⁴ Minnesota, in the leading case of *Hospes v. Northwestern Manufacturing & Car Co.*,¹⁵ decided by Mr. Justice Mitchell, soundly rejected the trust fund doctrine as an unrealistic fiction. In its stead, the court in *Taylor v. Mitchell*¹⁶ adopted the approach that as an equitable principle a corporate director owes a fiduciary duty to the creditors of an insolvent corporation which forbids him from preferring himself over those creditors. It was this equitable principle that the court in *Tomlinson* invoked to protect Burlington, the creditor of Tomlinson Sales.

Application of the *Taylor v. Mitchell* line of case law, however, has been limited in the past to cases where the director was a creditor of the insolvent corporation,¹⁷ a situation only analogous to the *Tomlinson* facts. The *Tomlinson* court's use of the *Taylor v. Mitchell* theory reached an equitable result, but an alternative approach of utilizing the fraudulent conveyances statute, which was not argued by the parties, might have resolved the case more directly.

Fraudulent conveyances law in Minnesota is governed primarily by the Uniform Fraudulent Conveyances Act (U.F.C.A.),¹⁸ which creates two major types of fraudulent conveyances: those constructively fraudulent¹⁹ and those fraudulent upon a showing of intent to hinder, delay, or defraud creditors.²⁰ Tomlinson probably violated both provisions by converting the current accounts receivable of Tomlinson Sales into long-term indebtedness.

To take advantage of the U.F.C.A., one must be a "creditor"²¹ and the transaction involved must constitute a "conveyance."²² The U.F.C.A. does not specifically state that a receiver, such as Swanson, is a creditor

13. See, e.g., *Taylor v. Mitchell*, 80 Minn. 492, 83 N.W. 418 (1900) (defendant directors mortgaged corporate property to themselves, then foreclosed on property).

14. See generally 15A W. FLETCHER, *supra* note 2, at §§ 7369-89.

15. 48 Minn. 174, 50 N.W. 1117 (1892).

16. 80 Minn. 492, 83 N.W. 418 (1900).

17. See cases cited note 8 *supra*.

18. MINN. STAT. §§ 513.20-.32 (1976).

19. *Id.* § 513.23 (voluntary conveyance for no consideration by insolvent corporation is constructively fraudulent).

20. *Id.* § 513.26.

21. The Act defines a "creditor" as "a person having any claim, whether matured or unmatured, liquidated or unliquidated, absolute, fixed or contingent." *Id.* § 513.20.

22. A "conveyance" is defined by the Act as including "payment of money, assignment, release, transfer, lease, mortgage, or pledge of tangible or intangible property, and also the creation of any lien or encumbrance." *Id.*

under the Act, and an early Minnesota commentator suggested he would not be.²³ The Minnesota Supreme Court has held, however, that a receiver appointed in a proceeding subsequent to execution has equitable power to set aside a fraudulent conveyance, and in so doing “stands in the place of the creditor, and prosecutes the action in his behalf.”²⁴ Such a holding is consistent with the receiver’s role as representative of the creditors, and therefore Swanson probably could have utilized the Act.²⁵

The U.F.C.A. defines a conveyance to include a “release.”²⁶ In *Tomlinson*, Tomlinson Sales released the other Tomlinson corporations from their current obligations due on open account and substituted without consideration a long-term obligation of unquestionably less value. Because the Act’s definition of conveyance is intended to be read broadly,²⁷ the transaction in *Tomlinson* could quite easily have been found to be a release of the current debts and therefore constitute a conveyance.²⁸ Consequently, the prerequisites to the application of the U.F.C.A. probably were present in *Tomlinson*.

To establish constructive fraud under the U.F.C.A., a creditor must

23. See Bridgman, *Uniform Fraudulent Conveyance Act in Minnesota* (pt. 2), 7 MINN. L. REV. 530, 538 (1923) (no authority cited for this proposition).

24. Dunham v. Byrnes, 36 Minn. 106, 108, 30 N.W. 402, 403 (1886); accord, Merrill v. Zimmerman, 152 Minn. 333, 336, 188 N.W. 1019, 1020 (1922); see Tvedt v. Mackel, 67 Minn. 24, 69 N.W. 475 (1896); Sawyer v. Harrison, 43 Minn. 297, 45 N.W. 434 (1890). In Healy-Owen-Hartzel Co. v. Montevideo Farmers & Merchants Elevator Co., 170 Minn. 290, 212 N.W. 455 (1927), the Minnesota Supreme Court denied appointment of a receiver on grounds that the judgment creditor’s remedies under MINN. STAT. § 513.28 (1976) were adequate. Recognizing that courts have broad discretion in determining whether a receiver shall be appointed, one of two implications could be drawn from *Healy*. First, a receiver’s powers are equal to those of the judgment creditor. Second, a receiver’s powers are broader, extraordinary powers and may not be necessary in some cases. Either would explain the holding in *Healy* and both support the power of a receiver to use the Act.

25. If the receiver cannot use the Act, then he would have to revert to common-law fraudulent conveyance law which could cause different results. Under the common-law, a conveyance is not considered constructively fraudulent even if made by an insolvent person for no consideration, see, e.g., Underleak v. Scott, 117 Minn. 136, 134 N.W. 731 (1912), while under the Act such conveyances are constructively fraudulent, see note 19 *supra*.

26. See note 22 *supra*.

27. See Bridgman, *supra* note 23, at 461; cf. Kummet v. Thielen, 210 Minn. 302, 298 N.W. 245 (1941) (purpose of Act is to prevent debtors from putting property which is available for payment of their debts beyond reach of their creditors); Atwater v. Manchester Sav. Bank, 45 Minn. 341, 48 N.W. 187 (1891) (confession of judgment may be fraudulent conveyance).

28. A right to current payment of an amount is obviously worth more than a right to receive that amount at a future date. See E. HELPFERT, *TECHNIQUES OF FINANCIAL ANALYSIS* 126 (3d ed. 1972). *Tomlinson* is analogous to the fraudulent transfer in *Hall & Farley v. Alabama Terminal & Improvement Co.*, 39 So. 285 (Ala. 1905), where an insolvent corporation released solvent stock subscribers and substituted insolvent stock subscribers. In *Hall*, the corporation released a debt of value for one of no value, while in *Tomlinson* the corporation released a debt of some value for an obligation of considerably less value.

prove the debtor was insolvent at the time of the conveyance and the conveyance was not made for fair consideration.²⁹ In *Tomlinson*, the conveyance was made for no consideration, and therefore the only issue would concern the insolvency of Tomlinson Sales. The opinion was not entirely clear as to the financial status of Tomlinson Sales, stating at one point that the corporation was not insolvent from a purely accounting viewpoint, having more assets than liabilities, but that the conversion effectively rendered it insolvent in the sense that it could not pay its obligations as they matured.³⁰ Consequently, the court seemed to find that Tomlinson Sales was solvent before the conversion of the accounts receivable but that the conversion rendered it insolvent. Therefore, under the U.F.C.A., the conversion was constructively fraudulent.³¹

Even if not constructively fraudulent, a conveyance can be set aside under the U.F.C.A. without a showing of insolvency if made with intent to hinder, delay, or defraud creditors.³² Tomlinson admitted the purpose of the conversion was to forestall the financial demise of all the Tomlinson corporations.³³ This admission seems necessarily to imply that Tomlinson intended to delay or hinder the collection of the Burlington debt, and the courts will presume such an intent if the conveyance has the effect of delaying or hindering creditors.³⁴ Therefore, the facts of *Tomlinson* could have supported a finding that the conveyance was either constructively fraudulent or intentionally fraudulent under the Uniform Fraudulent Conveyances Act, as well as supporting the stated basis for the court's decision.³⁵

29. See MINN. STAT. § 513.23 (1976).

30. See note 6 *supra*.

31. See MINN. STAT. § 513.21 (1976); Note, *Application of the Uniform Fraudulent Conveyance Act*, 46 HARV. L. REV. 404, 420 (1933). See also *Gipson v. Bedard*, 173 Minn. 104, 217 N.W. 139 (1927) (dictum) (rejected test of insolvency as being inability to meet one's obligations as they mature in the regular course of business without taking into account debtor's assets).

32. See MINN. STAT. § 513.26 (1976).

33. See note 3 *supra* and accompanying text.

34. See *Greenleaf v. Edes*, 2 Minn. 264 (Gil. 226) (1858); cf. Note, *supra* note 31, at 415 (conveyance by corporation in consideration of benefits to affiliated corporation should be invalid).

35. *Tomlinson* also may have been a proper case for invocation of the piercing the corporate veil doctrine. See, e.g., *Central Motors & Supply Co. v. Brown*, 219 Minn. 467, 18 N.W.2d 236 (1945) (corporation cannot be utilized to shield property from one's creditors); *Matchan v. Phoenix Land Inv. Co.*, 159 Minn. 132, 198 N.W. 417 (1924) (common-law fraudulent conveyances case where several corporations were used to defraud creditors and court pierced corporate veil). But see *General Underwriters, Inc. v. Kline*, 233 Minn. 345, 46 N.W.2d 794 (1951) (facts parallel those in *Tomlinson*; held unnecessary to pierce the corporate veil where fraudulent conveyance is present). See generally Clark, *The Duties of the Corporate Debtor to Its Creditors*, 90 HARV. L. REV. 505 (1977) (discussion of relationship between doctrines of equitable subordination, fraudulent conveyances, and piercing the corporate veil).