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Harold Dudley Greeley

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Legal Notes

Harold Dudley Greeley, *Editor*

DAMAGE SUIT AGAINST ACCOUNTANTS

Another damage suit, in which about $200,000 is sought, is pending against a firm of accountants. It has not yet been tried and thus the facts have not been judicially determined but the court had occasion on May 20th to lay down certain legal principles and to endorse generally the decision in *Ultramares Corporation* v. *Touche*, 255 N. Y. 170. The plaintiff, a bank, is suing on the allegation of deceit. The court was asked to dismiss the case on the written pleadings or statements by each party without a trial, but it refused to do so and stated that the damages alleged were not conjectural or speculative and that the amount could be proved upon a trial of the facts. The facts as alleged, were as follows:

A certain corporation asked plaintiff for a time loan of $300,000. This was refused, but plaintiff made a demand loan of this amount and agreed to change it to a time loan if a certified balance-sheet were furnished which would warrant a time loan. Defendants certified such a balance-sheet which was presented to the plaintiff and plaintiff in reliance upon it changed the loan from demand to time. Defendants in the preliminary move now being discussed claimed that plaintiff suffered no damage by thus changing the loan in terms but not in amount.

The court stated that fraudulent misrepresentations which transmute indecision into a damaging decision connote damages and that one guilty of making the misrepresentation will not be permitted to say what the one defrauded would or would not have done, or that the innocent might have suffered damage if the fraud had not been concocted or no deception had been practised. It may fairly be assumed that the one deceived would have acted for his own protection had the expected truth been told instead of the false statement upon which reliance was placed. The court then quoted from the *Ultramares* case: "Where a person within whose special province it lay to know a particular fact has given an erroneous answer to an inquiry made with regard to it by a person desirous of ascertaining the fact for the purpose of determining his course accordingly, he has been held bound to make good the assurance he has given."

While no presumption of damage arises from a representation proved to be false, the nature of the representation may be such that injury from acting upon it may be inferred. In the latter category, it would seem, said the court, "is the representation here allegedly, recklessly and wantonly made in the financial statement of a corporation certified for correctness by the defendants, certified public accountants, to induce action by the plaintiff bank. The damage claimed is $197,561.27, the difference between the amount loaned and the amount received by plaintiff as dividends upon the distribution in bankruptcy of the borrowing corporation's estate."

This case raises an interesting question of law. Was the plaintiff damaged, notwithstanding the sum was actually lent before the balance-sheet was

certified, by the change of the loan into one for a fixed period of time and by plaintiff's surrender of the demand note and its right to proceed for collection at any time it thought proper? This difficulty is an apt vindication of the judgment of the seniors at Yale who, according to *The New Yorker* for May 27, 1933, voted accounting the "hardest subject."

TAX DISCRIMINATION AGAINST CHAIN STORES

Social and political reformers have often found taxation a ready weapon with which to fight those who disagree with them, just as the federal government has found it convenient to incarcerate offenders against income-tax laws when there was at least a suspicion that the men concerned had committed more serious offenses. Thus by indirection do we seek direction out. The curbing of chain stores has been sought through prohibitive taxation. The United States supreme court has recently laid down certain principles of law to be observed in such efforts, Justices Brandeis, Stone and Cardozo dissenting in part. The case before the court was *Liggett Co.* v. *Lee*, 53 Sup. Ct. 481, which involved a Florida statute. That law levied a tax on the privilege of conducting retail stores within the state. The tax was to increase with the number of stores operated by the same owner and it was to increase further if the stores were located in more than one county. Merchandise carried by retail merchants was to be taxed at a higher rate than merchandise carried by wholesalers. This statute was attacked on the ground that its method of discriminating was in violation of the constitutional guaranty of equal protection. The court held that wholesalers could be treated differently from retailers and that chain stores could be singled out for taxation but that the discrimination between those operating in one county and those operating in more than one county was arbitrary and thus violative of the equal protection principle established by the constitution.

DUTIES OF DIRECTORS

"Directors should direct," writes Mr. Justice Black of the New York supreme court as the first words of his opinion in *Irving Trust Co., trustee in bankruptcy of International Match Corp'n* v. *Allen et al.*, 89 N. Y. LAW JOURNAL 3375 (June 5, 1933). This action was brought against seven directors of the corporation on an allegation that the directors had unlawfully abdicated, delegated and surrendered their powers and duties to Mr. Kreuger when his interests were adverse to those of the corporation, whereby the corporation incurred losses. Six of the defendants immediately asked the court to dismiss the action without a trial, on the ground that the plaintiff in its complaint, that is, the written allegations upon which the action was based, had failed to state a cause of action against them. Defendants' motions to dismiss were denied because the court decided that plaintiff's allegations of nonfeasance and misfeasance were legally sufficient to raise issues to be proved on a trial.

Judge Black's opinion contains much sound advice for corporate directors. Although legal remedies against directors today are almost wholly statutory, there never has been a time when a legal remedy did not exist against directors who neglected their duties and did not direct. Directors are personally liable if they permit corporate funds or property to be lost or wasted because of their negligence or inattention to their duties. The basis for this responsibility is the trust relation which they bear to the corporation and its stockholders. A

director is bound to exercise the same degree of care in the performance of his duty that a man of common prudence generally shows in his own affairs. The law has no place for dummy directors. As was pointed out in *Walker* v. *Man*, 142 Misc. (N. Y.), 277, "Passivity and disavowal of knowledge alone do not constitute a pass to freedom from responsibility. A director may not shut off liability by shutting off his hearing and sight." And a Tennessee court has said that culpable negligence is the equivalent of fraud (*Shea* v. *Mabry*, 1 Lea, Tennessee, 319, 342). A director may be liable for negligence in allowing wrongful acts to be committed after he becomes a director although the resolutions authorizing such wrongful acts had been adopted prior to his election. Even the employment of professional accountants will not always relieve directors from their duty to inform themselves as to the true condition of the corporation's affairs (*Tri-Bullion Smelting Co.* v. *Corliss*, 186 App. Div. (N. Y.), 613, affirmed in 230 N. Y. 629).