ACQUISITION OF PROPERTY BY DISSOLVED CORPORATIONS DURING THE STATUTORY WINDING UP PERIOD*

Common law, having created a fictional life in corporate bodies, carried the analogy to its logical extreme and endowed them with a fictional death upon dissolution.¹ This demise left no heirs to take over the estate of the deceased: pending suits were abated,² debts were extinguished,³ and any property rights held by the corporation were immediately forfeited.⁴ Such results were relatively harmless at a time when the function of a corporation was merely to enable an ecclesiastical or municipal organization ⁶ to hold land

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* Nardis Sportswear v. Simmons, 218 S.W.2d 451 (Tex. 1949).
3. See 16 FLETCHER, op. cit. supra note 2, §8127; 1 BL. COMM. *484. It is doubtful whether this result was ever actually achieved in this country. See Marcus, supra note 2, at 677-80; BALLANTINE, CORPORATIONS §312 (rev. ed. 1946). The obvious harshness of such a rule was excused by the statement that creditors must be presumed to understand the nature and incidents of the corporate body, and to contract with reference to them. See Mumma v. Potomac Co., 8 Pet. 281, 286 (U.S. 1834).
4. The traditional statement was that personal property escheated to the monarch, and real property reverted to the grantor. See 1 BL. COMM. 326-7, n.21 (Cooley's 2d ed. 1872); 8 THOMPSON, CORPORATIONS §6506. Some commentators have insisted that this rule was never supported by adequate authority, but has simply been handed down from text to text as if true. See BALLANTINE, CORPORATIONS §313 (rev. ed. 1946); 16 FLETCHER, op. cit. supra note 2, §8134; Note, 3 HARV. L. REV. 135 (1889). The rule has, however, been applied in this country to non-business corporations at least. E.g., Church v. United States, 136 U.S. 1 (1889) (church lands forfeited to the sovereign); Danville Seminary v. Mott, 136 Ill. 289, 28 N.E. 54 (1891) (lands of charitable organization reverted to donor). Material concerning the doctrine of reverter is collected in 47 A.L.R. 1288, 1328-55 (1927).
5. See Bacon v. Robertson, 18 How. 480, 487 (U.S. 1855). One of the earliest treatises on corporations devotes seventy pages to dissolution and its effect without mentioning a business corporation; examples used therein range from the Order of Templars to the City of London. 2 KYD, LAW OF CORPORATIONS 446-516 (1794). See also Marcus, supra note 2, at 678, n. 12.
beyond the span of an individual's lifetime. Since corporations then had no stockholders, and few if any creditors, no sudden financial losses were incurred. But with the growth of a market-credit economy, corporate wealth became embodied in extremely complex legal relationships which could not be summarily terminated, and it became necessary to devise a method whereby corporate assets could be translated into money and distributed to creditors and stockholders.

To meet this problem, states now have statutory provisions which endow dissolved corporations with a life after death. These statutes give the trustees of the corporation time in which to sue and be sued, to settle accounts and pay off debts, to dispose of corporate property, and generally to terminate the affairs of the corporation. During the time limit established by

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6. "But, as all personal rights die with the person; and, as the necessary forms of investing a series of individuals, one after another, with the same identical rights, would be very inconvenient, if not impracticable; it has been found necessary ... to constitute artificial persons, who may maintain a perpetual succession, and enjoy a kind of legal immortality." 1 Bl. Com. 3467.

7. See, e.g., Mott v. Danville Seminary, 139 Ill. 403, 410, 21 N.E. 927, 923 (1899); McAlhany v. Murray, 89 S.C. 440, 444, 71 S.E. 1025, 1026 (1911).

8. Courts early realized the necessity of protecting creditors, and the common law treatment of dissolved corporations became shot through with exceptions, mainly through the interference of equity. See cases collected in 47 A.L.R. 1253, 1355-64 (1937); Ballantine, Corporations §§ 312-13. The device used for preservation of assets was the concept of a trust fund for the benefit of creditors. The "trust fund" theory was first developed by Justice Story in Wood v. Dummer, 30 Fed. Cas. 435, No. 17,944 (C.C.D.Me. 1824). Later this device was extended for the protection of the stockholders. E.g., Bacon v. Robertson, 18 How. 480 (U.S. 1855); see Folger v. Columbian Ins. Co., 99 Mass. 267, 276-7 (1868).

While the trust fund concept protected creditors and stockholders from irresponsible dissipation of assets by giving them a cause of action against the trustees, it was not designed to afford the trustees opportunity to take the affirmative action necessary to achieve complete protection of parties who were still financially interested after dissolution.

9. E.g., Ala. Code, tit. 10, § 110 (1940) (for five years, plus an additional five-year period upon application to the court); Del. Code, c. 65, § 42 (1935) (for three years, plus sufficient time to resolve all litigation commenced within the three-year period); N.Y. Stock Corp. Law § 105 (8) (for an indefinite period); Ore. Corp. Laws Ann. §§ 77-259 (Supp. 1947) (for five years with provision for extension for purpose of suits involving real estate). The provisions are usually coupled with one for the appointment of a trustee to handle litigation in the name of the corporation. E.g., Kan. Gen. Stat. Ann. § 17-3607 (Corrick, Supp. 1947). A few states have not expressly extended the corporation's existence, but have made the directors of the corporation statutory trustees charged with responsibility for the assets during the winding up operation. E.g., Colo. Stat., c. 41, § 62 (1935). This last method constitutes codification of the equitable trust fund doctrine. See Hornstein, Voluntary Dissolution—A New Development in Intracorporate Abuse, 51 Yale L. J. 64, 71-5 (1941). Extensive, although out-of-date, material on the statutory provisions of each state is collected in 47 A.L.R. 1253, 1397-1537 (1927).

10. The language of the Texas statute is typical:

"Upon the dissolution of a corporation ... the president and directors ... shall
the statute, it may become financially expedient for the trustees to enforce
executory contracts and options. The disposal of property is specifically
authorized. And in Nardis Sportswear v. Simmons \(^{11}\) the Texas Supreme
Court recently interpreted the state winding-up statute \(^{12}\) to allow a dis-
solved corporation, even in the absence of specific authorizing language,
to acquire property by enforcing an option during the statutory period of
life after death.

In the Nardis case, the plaintiff corporation, a clothing manufacturer,
held a five-year lease on certain Dallas real estate, with an option to pur-
chase at a fixed price. At the time of dissolution, the lease had about two
and a half years to run. The trustees subsequently sought to exercise the
option, but since real estate values had risen since the signing of the lease,
the lessor refused to execute a deed. In a suit for specific performance, a
directed verdict by the trial court for the defendant lessor was affirmed by
the Texas Court of Civil Appeals, principally on the theory that under
the winding up statute a dissolved corporation was wholly without power to
acquire property.\(^{13}\) The Supreme Court of Texas reversed, holding that the
option to purchase land was an asset within the scope of the winding up

be trustees of the creditors and stockholders of such corporation, with power to settle
the affairs, collect the outstanding debts, and divide the moneys and other property among
the stockholders after paying the debts . . . and for this purpose they may in the name
of such corporation, sell, convey and transfer all real and personal property belonging
to such company, collect all debts, compromise controversies, maintain or defend judicial
proceedings, and exercise full power and authority of said company over such assets and

“The existence of every corporation may be continued for three years after its dis-
solution from whatever cause, for the purpose of enabling those charged with the duty
to settle up its affairs.” Id., art. 1389.

These statutes have been interpreted to permit actions which, at first glance, seem
to have little bearing on disposal of assets in a strict sense. See, e.g., In re International
Sugar Feed Co., 23 F.Supp. 197 (D.Minn. 1938) (dissolved corporation permitted to
file petition for reorganization proceedings under § 77B of Bankruptcy Act); Bruun v.
Cook, 280 Mich. 484, 273 N.W. 774 (1937) (election of new officers); Tenison v. Wilson,
151 S.W.2d 327 (Tex.Civ.App. 1941) (trustees allowed to organize new corporation to
take over assets of dissolved corporation).

11. 218 S.W.2d 451 (Tex. 1949).
cision was partially based on the provisions of a Texas statute prohibiting a corporation
from purchasing any land unless such land is necessary to enable the corporation to do
business, or is acquired in due course of business to secure the payment of a debt. Tex.
Civ. Stat., tit. 32, art. 1359 (1925). Moreover, the court felt very strongly that the
winding up statute did not authorize a dissolved corporation to exercise an option to
buy under any circumstances:

“Thus I think the conclusion inescapable that the dissolved corporation was wholly
without power to purchase real estate, or anything else, as it was out of business, and
its trustees were not authorized in the winding-up procedure to exercise powers greater
than those remaining with the dissolved corporation.” 213 S.W.2d 864, 872 (Tex.Civ.App.
1948).
statute. It therefore survived dissolution of the corporation, and could be exercised if such action was necessary to settle properly the affairs of the dissolved corporation.\textsuperscript{14}

This result gives concrete expression to the policy behind winding up statutes—the protection of creditors and the reimbursement of stockholders.\textsuperscript{15} Since creditors have a priority claim on the assets of the corporation,\textsuperscript{16} these statutes must, of course, be construed to favor them over stockholders.\textsuperscript{17} But where, as in this case, there is no conflict between creditors and stockholders, trustees should be permitted to reap the maximum gain for the stockholders.\textsuperscript{18} In the instant case, for example, the corporation had gone out of business, but was still obligated to pay rent for the unexpired term of the lease.\textsuperscript{19} And provisions in the lease made subletting or assign-
ment impossible. The option was similarly unassignable. Therefore, only by exercising the option could the trustees protect the stockholders. And in view of the rise in real estate values which had occurred since the price had been set, purchase was a prudent business move.

Consistent with the desire to protect creditors and stockholders, courts have placed two types of restrictions on the powers of trustees acting under a winding up statute. First, action in bad faith, designed to benefit the trustees to the detriment of creditors and stockholders, is prohibited. There was no question of this in the Nardis case. Second, the action must be necessary to the winding up process. But this latter requirement has not been so rigidly interpreted as to prevent survival of potential property rights embodied in executory contracts. For instance, in Michigan an

And the duty of the corporate lessee to pay rent survives with it. People v. National Trust Co., 82 N.Y. 283 (1880).

20. The terms of the lease are given in detail in Nardis Sportswear v. Simmons, 213 S.W.2d 864, 865-6 (Tex.Civ.App. 1948).

21. Where a lease contains a provision against assignment, an option contained in the lease is not separable, and hence is also not assignable. Prichard v. Kimball, 190 Cal. 752, 214 Pac. 863 (1923); see cases cited in 38 A.L.R. 1172-3 (1925).

22. A possible alternative would be reincorporation for the purpose of holding the lease and exercising the option. It seems probable, however, that the formation of a new corporation for such a purpose would constitute assignment of the lease and forfeiture of the option rights. See Gatley v. Shockley, 215 Cal. 604, 12 P.2d 436 (1932); cf. Berrien County Fruit Exchange v. Pallas, 314 Mich. 66, 22 N.W.2d 74 (1946) (such action permitted where non-assignment clause had been stricken from the lease).

There was no way in which the Nardis corporation could use the premises for business purposes. Express prohibition against continuation of business as usual is included in several winding up statutes. Del. Code, c. 65, § 42 (1935); Mass. Laws, c. 155, § 51 (1948); Mich. Stat., tit. 21, § 21.75 (1937); N.J. Stat. Ann. § 14:13-1 (1937). And where the prohibition is not express, it is implied. E.g., Houston v. Utah Lake Land, Water & Power Co., 55 Utah 393, 187 Pac. 174 (1919); see McBride v. Clayton, 140 Tex. 71, 75-6, 166 S.W.2d 125, 128 (1942).

23. The trustees must act in good faith to benefit all the stockholders, not merely some of them. E.g., Mason v. Pewabic Mining Co., 133 U.S. 50 (1890). And they may not attempt to benefit themselves to the detriment of stockholders. E.g., Finch v. Finch, 68 Cal.App. 72, 228 Pac. 553 (1924) (trustee-stockholder accepted, in his capacity as trustee, his own stock for cancellation, thus increasing the liability of other stockholders); Young v. Blandin, 215 Minn. 111, 9 N.W.2d 313 (1943) (after liquidating assets in lump conveyance for $5,000,000, trustee played stock market with proceeds). Nor may they act with the purpose of benefitting stockholders at the expense of creditors. See notes 16 and 17 supra.

24. See McLoughlin Land & Livestock Co. v. Bank of America, 94 F.2d 491, 493 (9th Cir. 1938); Young v. Blandin, 215 Minn. 111, 117, 9 N.W.2d 313, 316 (1943); cases cited note 22 supra.

option to renew a lease has been held enforceable after dissolution, despite
the fact that the new term extended beyond the period permitted for wind-
ing up.\textsuperscript{26} The only additional difficulty raised in the \textit{Nardis} case was the
conceptual point that the trustees’ action was designed to convert a po-
tential property right into actual “title”. The problem facing the court was
a practical one: should a dissolved corporation, whose existence had been
prolonged for limited purposes by statute, be permitted to make a “windfall”
profit on an asset which had not been realized before dissolution? \textsuperscript{27} Actually,
however, no more of a “windfall” is involved in such action than in the dis-
posal of inventory stocks which have risen in price. It is clear, moreover,
that refusal to enforce the option would simply permit the lessor to escape
the consequences of a bad bargain because of the purely fortuitous dissolu-
tion of the corporate lessee.

The court in the \textit{Nardis} case reached a conclusion consonant with modern
business realities. In planning ahead, a corporation must constantly make
and receive future commitments which embody within themselves profit
expectations. If these commitments are abrogated, a portion of the cor-
porate assets is effectively dissipated. By allowing a dissolved corporation
to capitalize on the agreements made during its corporate life, the \textit{Nardis}
case affords creditors a fuller measure of protection and enables stockholders
to receive the fruits of their original investment.

\textsuperscript{1949}\textsuperscript{1} 

\textsuperscript{26} Kay Furniture Co. v. Rovin, 312 Mich. 290, 20 N.W.2d 194 (1945).

\textsuperscript{27} The intermediate appellate court, in deciding that it should not, called the trans-
action “a real estate speculation pure and simple.” \textit{Nardis} Sportswear v. Simmons, 213