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Corporation-Ratification of Unauthorized Acts-Imputation of Notice

CORPORATIONS—RATIFICATION OF UNAUTHORIZED ACTS—IMPUTATION OF NOTICE.—Defendant, a plumbing contractor, performed services for McKnight, who was a stockholder and director of the plaintiff corporation, and who for fourteen years had been in charge of the retail store operated by the corporation. Defendant and McKnight entered into a contract whereby defendant was to purchase supplies from the corporation and these were to be set off against McKnight's indebtedness to defendant. The purchases extended over a period of several years, during which time defendant never received a bill from the corporation, but regular invoices were sent. This action was to recover for the goods sold and delivered. Defendant counterclaimed, alleging that the corporation was bound by the contract made by McKnight. Held, by acquiescing in the agreement, the corporation had ratified it.[1]

The principal question involved in a discussion of this case is whether the agreement was ratified by the corporation. It is true that an agreement can be ratified by acquiescence.[2] However, ratification by acquiescence requires that the one ratifying have notice of the agreement.[3] In the present case it was not shown that anyone connected with the corporation, except McKnight and possibly those working under him, had any actual knowledge of the agreement. How, then, could the corporation have notice of the agreement? In the principal case, the court held that directors of a corporation

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18 Harper, supra, Sec. 109, p. 255.

19 Physical exertion, as well as the heat from the sun, is a contributing cause of sunstroke. Draper, Legal Medicine, p. 461.

1 Fayette Lumber Co. v. Faught (Ind. App., 1937), 5 N. E. (2d) 132.

2 Seymour Improvement Co. v. Viking Sprinkler Co. (1927), 87 Ind. App. 179, 161 N. E. 389; Hoosier Lumber Co. v. Spear (1934), 99 Ind. App. 532, 189 N. E. 633; National Life Ins. Co. v. Headrick (1916), 63 Ind. App. 54, 112 N. E. 559; American Quarries Co. v. Lay (1905), 37 Ind. App. 386, 73 N. E. 608; Washburn-Crosby Mill Co. v. Brown (1913), 56 Ind. App. 104, 104 N. E. 997; Indiana Union Traction Co. v. Scribner (1910), 47 Ind. App. 621, 93 N. E. 1014; Outing Kumfy-Kab Co. v. Ivey (1920), 74 Ind. App. 286, 125 N. E. 234.

3 National Life Ins. Co. v. Headrick (1916), 63 Ind. App. 54, 112 N. E. 559; Indiana Union Traction Co. v. Scribner (1910), 47 Ind. App. 621, 93 N. E. 1014; Outing Kumfy-Kab Co. v. Ivey (1920), 74 Ind. App. 286, 125 N. E. 234; Crowder v. Reed (1881), 80 Ind. 1; Crumpacker v. Jeffry (1916), 63 Ind. App. 621, 115 N. E. 62; Kline v. Indiana Trust Co. (1920), 74 Ind. App. 351, 125 N. E. 434.

are presumed to know that which it is their duty to know and which they have the means of knowing.[4] Now, was it the duty of the directors to know the exact nature of an agreement between a purchaser in the ordinary course of business and its manager? The obvious answer would be that such a requirement would impose too great a burden on directors who receive little, if any, compensation for their services. It would seem that directors should not be required to investigate every transaction, but that they could assume that such transactions would be regular. Directors are bound to exercise ordinary care and diligence in the discharge of their duties.[5] It is possible that the directors were somewhat negligent in allowing defendant's account to run over a period of years, but even this is a questionable matter, for the account was not large and the directors might reasonably assume that their manager knew defendant and believed him to be a good risk.[6]

In the present case the court said that the law imputes to a corporation knowledge of facts which its directors ought to know in the exercise of ordinary diligence, in discharge of their official duties, when imputation of such knowledge is necessary to protect the rights of third persons. As a general proposition, this may be a true statement of the law.[7] However, it appears inapplicable to the facts of the present case for the following reasons: First, as previously shown, the directors could hardly be said to have the duty to acquire knowledge of facts regarding a transaction in the ordinary course of the business. Second, while it is true that notice to an agent of a corporation, relating to any matter of which he has the management and control, is notice to the corporation,[8] this rule is inapplicable to cases where the officer is acting in his individual capacity in a transaction with the corporation,[9] or where he is adversely interested,[10] or where he is participating in a fraud on the corporation,[11] in which cases notice will not be imputed.

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[4] Seymour Improvement Co. v. Viking Sprinkler Co. (1927), 87 Ind. App. 179, 161 N. E. 389; Hoosier Lumber Co. v. Spear (1934), 99 Ind. App. 532, 189 N. E. 633.

[5] General Rubber Co. v. Benedict (1915), 215 N. Y. 18, 109 N. E. 96; Hun v. Cary (1880), 82 N. Y. 65; Chicago Title and Trust Co. v. Munday (1921), 297 Ill. 555, 131 N. E. 103; Delano v. Case (1887), 121 Ill. 247, 12 N. E. 676.

[6] Briggs v. Spaulding (1891), 141 U. S. 132, 11 S. Ct. 924; Bates v. Dresser (1920), 251 U. S. 524, 40 S. Ct. 247.

[7] Seymour Improvement Co. v. Viking Sprinkler Co. (1927), 87 Ind. App. 179, 161 N. E. 389; National Life Ins. Co. v. Minch (1873), 53 N. Y. 144.

[8] Seymour Improvement Co. v. Viking Sprinkler Co. (1927), 87 Ind. App. 179, 161 N. E. 389; Indiana Union Traction Co. v. Scribner (1910), 47 Ind. App. 621, 93 N. E. 1014; Huber Manufacturing Co. v. Blessing (1912), 51 Ind. App. 89, 99 N. E. 132; Farmers Mutual Ins. Co. v. Jackman (1905), 35 Ind. App. 1, 73 N. E. 730; Supreme Court of Honor v. Sullivan (1901), 26 Ind. App. 60, 59 N. E. 37; Peckham v. Hendren (1881), 76 Ind. 47.

[9] Peckham v. Hendren (1881), 76 Ind. 47; Ayers v. Green Gold Mining Co. (1897), 116 Cal. 333, 48 Pac. 221.

[10] Innerarity v. Bank (1885), 139 Mass. 332, 1 N. E. 282; American Surety Co. v. Pauly (1898), 170 U. S. 133, 18 S. Ct. 552; Benedict v. Arnoux (1898), 154 N. Y. 715, 49 N. E. 326; Seaverno v. Presbyterian Hospital (1898), 173 Ill. 414, 50 N. E. 1079; Hadden v. Dooley (1899), 34 C. C. A. 338, 92 Fed. 274.

[11] Henry v. Allen (1896), 151 N. Y. 1, 45 N. E. 355; Innerarity v. Bank (1885), 139 Mass. 332, 1 N. E. 282; Allen v. South Boston R. Co. (1889), 150 Mass. 200, 22 N. E. 917; Corcoran v. Snow Cattle Co. (1890), 151 Mass. 74, 23 N. E. 727.

Third, the imputation of knowledge would not be necessary to protect the rights of the third person in the present case, for the third person knew that the manager was attempting to use corporate assets to pay his private obligations. This, it seems, should be sufficient to show that the third person was not entitled to the benefit of the imputation even though he was not actually participating in a scheme to defraud the corporation.[12]

In the present case, the court relies on and quotes extensively from the case of *Seymour Improvement Co. v. Viking Sprinkler Co.*,[13] which case is easily distinguished. In the Viking case, the president executed the contract for the installation of the sprinkler system and bills were sent from time to time as the work progressed. The directors could hardly escape having knowledge of the installation and that the corporation was looked to for payment. Further, the president and secretary were acting in good faith and their knowledge, therefore, could be imputed to the corporation. Also, the third party was acting in such a way as to be entitled to protection, and the corporation received the benefits of the contract. The court relied, also, on the case of *Hoosier Lumber Co. v. Spear*.[14] The facts in the Spear case were almost identical with those of the principal case: the president of the corporation in each case was paying a personal debt with the corporate assets. However, in the Spear case, it was shown that both of the other directors, the president being the third, had knowledge of and agreed to the contract, though no formal resolution was adopted. The court further found that the officers believed the agreement to be for the benefit of the corporation. Thus, it would appear that, while the court announced rules of law which are generally accepted, the rules thus announced are inapplicable to the facts of the instant case.

R. E. M.