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UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF WASHINGTON

In Re:)
METROPOLITAN MORTGAGE &)
SECURITIES CO., INC.,)
Debtor.)

Jointly Administered Under:
No. 04-00757-W11
Chapter 11

In Re:)
SUMMIT SECURITIES, INC.,)
Debtor.)

METROPOLITAN MORTGAGE &)
SECURITIES CO., INC.,)
Plaintiff,)
vs.)
SARAH EMMA QUINN,)
Defendant.)

Adversary No. 06-80028-PCW

FILED

AUG - 8 2006

T.S. MCGREGOR, CLERK
U.S. BANKRUPTCY COURT
EASTERN DISTRICT OF WASHINGTON

METROPOLITAN MORTGAGE &)
SECURITIES CO., INC.,)
Plaintiff,)
vs.)
WILLIAM F. SANDIFUR and KAREN)
SANDIFUR, husband and wife,)
and their marital community,)
Defendants.)

Adversary No. 06-80029-PCW

MEMORANDUM DECISION RE:
DEFENDANTS' MOTIONS FOR PARTIAL
JUDGMENT ON THE PLEADINGS

Metropolitan Mortgage & Securities Co., Inc., is a Chapter 11
debtor and has brought these consolidated adversary proceedings

1 against two stockholders seeking to recover stock dividends
2 distributed to the defendants. The defendants filed motions to
3 dismiss certain causes of action in the Complaints pursuant to B.R.
4 7012 and argue that, based solely on the allegations in the
5 Complaints, dismissal is appropriate. For purposes of the motions,
6 it will be assumed that the allegations in the Complaints are
7 true.¹ *Conley v. Gibson*, 355 U.S. 41, 78 S.Ct. 99, 2 L.Ed.2d 80
8 (1957).

9 The Complaints allege that at the time of the distributions to
10 the defendants,² the debtor plaintiff was insolvent or was rendered
11 insolvent by the distributions. Because the corporation was
12 insolvent or was rendered insolvent by the distributions, arguably
13 the distributions were unlawful and may be recouped. The
14 Complaints do not allege that either defendant had any knowledge of
15 the debtor plaintiff's financial affairs nor any role in its
16 management or operation. Both defendants are family members of the
17 individual who controlled the corporation at the time of the
18 distributions. Evidence in the underlying Chapter 11 demonstrates
19 that stock of the corporate plaintiff was publically traded at the
20 time these distributions occurred and that it had thousands of
21 stockholders. Distributions to other stockholders were also

22
23 ¹The two consolidated Complaints allege various causes of
24 action. Only state law causes of action are at issue in the
25 Motions to Dismiss. Those arising under 11 U.S.C. §§ 502(d) and
26 548 of the Bankruptcy Code are not subject to the pending Motions
to Dismiss on the Pleadings and remain to be resolved.

27 ²As alleged in the Complaints, the defendants were
28 beneficiaries of trusts and the distributions were made to the
trusts for the benefit of the defendants.

1 occurring. These defendants, over the course of approximately four
2 years, received in excess of half a million dollars in
3 distributions.

4 LEGAL ISSUES

5 1. Do the provisions of RCW 23B.06, etc., and .08, etc.,
6 imply a cause of action against the defendants?

7 2. Has the cause of action granted in RCW 19.40, etc., been
8 superseded by the provisions of RCW 23B.06.400?

9 RCW 23B.06 AND .08

10 In 1989, the Washington legislature replaced the state
11 statutory scheme relating to business corporations previously
12 codified as RCW 23A with a new scheme codified as RCW 23B, and
13 titled, "Washington Business Corporations Act." That statutory
14 scheme governs the formation, registration and dissolution of for-
15 profit corporate entities and their corporate governance.
16 RCW 23B.06 focuses on shares of stock: their issuance, record
17 keeping and transfers and also distributions, based on ownership of
18 shares. Subsection 400 provides that directors of a corporation
19 may authorize distributions or dividends based on ownership of
20 shares, unless the corporation is insolvent or the distribution
21 would render the corporation insolvent or unable to meet its
22 financial obligations. Distributions under such circumstances are
23 prohibited by RCW 23B.06.400.

24 RCW 23B.08, et. seq., is titled, "Directors and Officers."
25 That portion of the statutory scheme addresses the selection and
26 powers of directors, their duties and responsibilities, and
27 operational matters such as meetings, quorums, etc. Subsection 310
28 is the specific statute relied upon by the debtor plaintiff in

1 these adversary proceedings. Titled, "Liability for unlawful
2 distributions," that statute provides that directors who assent to
3 distributions made in violation of RCW 23B.06.400 are personally
4 liable to the corporation for the amount of the wrongful
5 distributions. Such a director is entitled, under
6 RCW 23B.06.310(2), to contributions from other directors and from
7 shareholders who received such distributions, if the shareholder
8 knew the distributions were made in violation of RCW 23B.06.400.

9 Does an Implied Cause of Action Exist in
10 Favor of the Debtor Plaintiff Against These Defendants?

11 RCW 23B.08.310 provides the debtor plaintiff with an express
12 cause of action and a remedy against its directors who assent to
13 and effectuate unlawful distributions. The debtor plaintiff argues
14 that this statute implies a cause of action on behalf of the
15 corporation against shareholders. That implied cause of action,
16 argues the debtor plaintiff, is against not just shareholders who
17 received the distribution with knowledge of the insolvency, but
18 against any shareholder who received a distribution. The result of
19 applying debtor plaintiff's argument is that the expressly granted
20 cause of action to directors to recover from shareholders is
21 narrower than the implied cause of action to corporations to
22 recover from shareholders, as the implied cause of action does not
23 contain a necessary element of the express cause of action, i.e.,
24 shareholders' knowledge of the corporation's insolvency.

25 In order for an implied cause of action to exist, Washington
26 courts have determined that certain conditions must be met; (1) The
27 debtor plaintiff must be in the class of persons for whose benefit
28 the statute was enacted, (2) There must be some demonstration of

1 legislative intent to create a cause of action, and (3) The implied
2 cause of action must be consistent with the underlying purpose of
3 the legislation. *M.W. v. Department of Social and Health Services*,
4 149 Wn.2d 589, 70 P.3rd 954 (2003).

5 **Persons Intended to be Benefitted**

6 RCW 23B.08.310 expressly grants the corporation a cause of
7 action against directors, although it does not grant the
8 corporation a cause of action against shareholders. Should the
9 legislature have desired to grant such a cause of action to
10 corporations, it could easily have done so in the statute, but it
11 did not. A reading of the statute leads to the conclusion that the
12 legislature, which did grant a cause of action to the directors
13 against shareholders, did not intend the corporation to hold such
14 a cause of action. This extrapolation of intent from the statutory
15 language is strengthened by the fact that recently the legislature
16 amended RCW 23B.08.310 to provide that the corporation may recover
17 distributions from a shareholder if that shareholder knew the
18 distribution was in violation of RCW 23B.06.400. The only
19 conclusion which can be drawn is that when it first enacted
20 RCW 23B.08.310, the legislature did not intend corporations to hold
21 such causes of action against shareholders. The class of persons
22 whom the cause of action against shareholders was intended to
23 benefit is the directors.

24 **Intent to Create Cause of Action**

25 When the legislature declares particular conduct to be
26 unlawful or prohibited but does not provide a course of redress to
27 persons injured by that conduct, courts have presumed that the
28 legislature intended the persons harmed to have a remedy. "Equity

1 will not suffer a wrong without a remedy." 1 Pomeroy's Equity
2 Jurisprudence, 4th Ed., § 423-424. In this situation, the unlawful
3 activity is the distribution of funds to stockholders during or
4 causing insolvency of the corporation. The legislative right to
5 redress that wrong is the corporation's right to recover the
6 distribution from the wrongdoer, i.e., the directors. Not only did
7 the legislature intend to provide redress, it expressly did so. If
8 the legislature had intended to create a cause of action against
9 other persons such as stockholders, it could easily have done so in
10 the initial enactment.

11 Underlying Purpose of Legislation

12 The existence of a cause of action against shareholders who
13 have no knowledge that the distributions occurred in violation of
14 RCW 23B.06.400(2) would not be consistent with the statutory
15 language. The statute limits the directors' rights to recover
16 distributions from stockholders to those who accepted the
17 distributions with such knowledge. The Complaints do not allege
18 these defendants had any such knowledge. The recent amendments to
19 RCW 23B.08.310 now allow corporations the right to recover such
20 distributions from shareholders but also limit that right to
21 shareholders with knowledge that the distributions violated RCW
22 23B.06.400. Expanding the right of recovery to the thousands of
23 shareholders of public companies who play no role in the
24 corporations' affairs would be contrary to the underlying theory of
25 shareholder liability in corporate organizations. It would also be
26 contrary to the legislative intent expressed in the statute.

27 RCW 23B.06.400 defines the unlawful conduct and RCW 23B.08.310
28 provides the right of redress. The debtor plaintiff has not

1 demonstrated that an implied cause of action exists in favor of the
2 debtor plaintiff against these defendants. Debtor plaintiff has
3 rights of recovery against its directors as provided in
4 RCW 23B.08.310 and is free to pursue those rights. It has no
5 rights of recovery against these shareholders under the applicable
6 enactment of RCW 23B.08.310.

7 Has the Cause of Action Provided in RCW 19.40
8 Been Superseded by RCW 23B.06.400?

9 The Uniform Fraudulent Transfer Act codified at RCW 19.40,
10 etc., generally provides that creditors of an insolvent corporation
11 may set aside transfers made by the corporation if the corporation
12 did not receive reasonably equivalent value at the time of the
13 transfer. Those causes of action granted to creditors may be
14 exercised by the insolvent corporation if it becomes a debtor in
15 bankruptcy. 11 U.S.C. §§ 544(b) and 550. There is no dispute that
16 this debtor plaintiff has been granted standing to pursue rights
17 under RCW 19.40, etc., by the Bankruptcy Code. The issue is
18 whether the causes of action granted in RCW 19.40, etc., if such
19 causes of action arise from distributions based on stock ownership,
20 have been extinguished and superseded by the enactment of
21 RCW 23B.06.400.

22 Cause of Action Under RCW 23B.06.400

23 RCW 23B.06.400(6) reads:

24 In circumstances to which this section and related
25 sections of this title are applicable, such provisions
26 supersede the applicability of any other statutes of this
state with respect to the legality of distributions.

27 The circumstances to which RCW 23B.06.400 is applicable are
28 those in which directors authorize and corporations make

1 distributions to stockholders based upon stock ownership.
2 RCW 23B.06.400(a). That is the specific topic addressed in this
3 particular statute. Thus, in determining whether such
4 distributions are unlawful, one must look solely to RCW 23B.06.400
5 or related provisions of RCW 23B, which would include
6 RCW 23B.06.310, rendering it unlawful for directors to make
7 distributions when the corporation is insolvent or would be
8 rendered insolvent by such distributions. RCW 19.40 addresses
9 transfers made by persons or corporations and obligations incurred
10 by persons or corporations. It is a statute of general
11 applicability relevant to many different circumstances, situations
12 and entities. RCW 23B.08.400, however, relates to specific types
13 of transfers to a specific group of recipients made only by for-
14 profit corporations. It does not at all relate to the incurring of
15 obligations. It is certainly the more specific statute, and
16 RCW 23B.06.400(6) has removed its subject matter from the more
17 general applicability of RCW 19.40.

18 The language of RCW 23B.06.400(6) deprives the debtor
19 plaintiff of a cause of action under RCW 19.40 if such cause of
20 action relates to the unlawful nature of a stock dividend as these
21 Complaints allege. Because the statute is unambiguous and its
22 meaning is clearly articulated in its express language, there is no
23 need to resort to a review of the legislative history. Although the
24 debtor plaintiff argues that the statute is ambiguous, a review of
25 the legislative history reflects that the legislative intent is
26 articulated in the statute and that the statute means what it says.
27 The commentary associated with RCW 23B.06.400 reads:

28

1 The Proposed Act establishes the validity of
2 distributions from the corporate law standpoint under
3 Proposed section 6.40 and determines the potential
4 liability of directors for improper distributions under
5 Proposed sections 8.30 and 8.31. The federal Bankruptcy
6 Act and state fraudulent conveyance statutes, on the
7 other hand, are designed to enable the trustee or other
8 representative to recapture for the benefit of creditors
9 funds distributed to others in some circumstances. In
10 light of these diverse purposes, and to minimize
11 management difficulties in administering the statutes,
12 Proposed subsection 6.40(f) provides that the provisions
13 in this title supersede those of the state fraudulent
14 conveyances act in determining the legality of a
15 distribution.

9 Comments, Washington Business Corporation Act, 1989 Journal of the
10 Senate at 3009 (emphasis added).

11 In conclusion, no cause of action exists under RCW 19.40.041,
12 .051 or .071 under the circumstances of this case. The sole causes
13 of action relating to alleged unlawful distributions of corporate
14 funds to stockholders based upon stock ownership are those set
15 forth in RCW 23B.06 and RCW 23B.08. Unfortunately for debtor
16 plaintiff, no right to sue has been granted the debtor corporation
17 under the applicable enactment of RCW 23B.06.310. Consequently,
18 the first and second causes of action in the Complaints, which are
19 based on Washington state law, must be dismissed, and the
20 defendants' Motions to Dismiss are **GRANTED**.

21 DATED this 8th day of August, 2006.

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24 PATRICIA C. WILLIAMS
25 Bankruptcy Judge
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