

RESTRICTIONS IMPOSED BY THE DIRECTORSHIP STATUS ON THE PERSONAL BUSINESS ACTIVITIES OF DIRECTORS

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Under our existing legal and economic order the individual can, with few exceptions, engage in business activities of his own choosing. Ordinarily he may purchase and sell property of all types and may take advantage of such business opportunities as present themselves. But the position of the corporate director—as distinguished from that of the individual having no fiduciary responsibility—is significantly different. His duties and his relationship to his company appreciably restrict his freedom to engage in purely personal business activities. It is the purpose of this article to examine the extent and bases of these restrictions.¹

It seems appropriate at the outset briefly to review the position occupied by the director in the corporate scheme of things. The propriety of directoral conduct in taking personal advantage of particular business opportunities can best be judged against a background of the objects and purposes for which the office of director was created.

The corporate director occupies a *sui generis* status. He is neither an agent nor a trustee, although in many instances the same considerations which have dictated judicial condemnation of the conduct of agents and trustees apply with equal force to directors.² Directors are the persons to whom the management of the incorporated enterprise is entrusted. Their great purpose is to bring the objects and purposes of their company to a successful fruition.³ In furtherance of this purpose directors are bound to manage the company in the interests of its owners—the shareholders—as a whole and not in the interests of any

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1. Cases in which a director uses corporate assets or facilities in connection with his appropriation of business opportunities are not treated herein. See, in this connection, Note (1939) 39 Col. L. Rev. 219, 227.

2. Stevens, *Corporations* (1936) 545, sec. 138.

3. Thompson, *Corporations* (3d ed. 1927) 797, sec. 1327; 1 Morawetz, *Private Corporations* (2d ed. 1886) 477, 483, secs. 510, 517.

particular group of owners.⁴ Their managerial duties achieve such a degree of legal and practical importance that if they fail to conduct the affairs of their enterprise with the care of reasonably prudent directors, they become liable to their company for negligent mismanagement.⁵

While directors are usually elected to office by company shareholders, their authority is said to be derived from the statute authorizing the existence of their company.⁶ And it is especially important to observe that when directors perform their official function they do so not as individuals, but as a duly constituted and assembled *board* of directors. They possess no individual authority to act for the company outside of such a meeting.⁷ It is their duty as a board to appoint the corporate agents and officers who, subject to their control, carry on the actual business of the company. Their power over corporate affairs is of such a plenary nature that they are free from shareholder supervision so long as they act without fraud and within the limits of the authority conferred on them and on the corporation.⁸ In short, the directors are the high priests of the corporate enterprise. They are the persons to whom the corporate destiny is entrusted.⁹

APPROPRIATION BY A DIRECTOR OF A BUSINESS OPPORTUNITY
WHICH PUTS IT IN HIS POWER TO AFFECT ADVERSELY
THE CONTINUATION OF THE CORPORATE ENTERPRISE
ON ITS THEN EXISTING BASIS¹⁰

A. The Lease Cases

The propriety of directoral conduct may be called in question where a director takes advantage of a business opportunity which permits him to affect adversely the method, manner, or basis on which his company has theretofore carried on its business.

4. See *Eliot v. Baker* (1907) 194 Mass. 518, 80 N. E. 450, 452; *Manson v. Curtis* (1918) 223 N. Y. 313, 119 N. E. 559.

5. Spellman, *Corporate Directors* (1931) 542.

6. *Manson v. Curtis* (1918) 223 N. Y. 313, 119 N. E. 559.

7. Stevens, *Corporations* (1936) 552, sec. 140.

8. Spellman, *Corporate Directors* (1931) 360.

9. See: *Wickersham v. Crittenden* (1892) 93 Cal. 17, 29; *Beaudette v. Graham* (1929) 267 Mass. 7, 12, 165 N. E. 671.

10. It will be noted in various cases considered herein that the director concerned also was a corporate officer, such as president, secretary, treasurer, etc. The decisions reached in these cases usually are placed on the ground, among others, of the directoral relation, although it is not unusual for the courts to assert also that the fiduciary duties of corporate officers are co-extensive with those of directors, a point of view which is open to

Illustrative of a situation of this type is the case of *Girard Co. v. Lamoureux*.¹¹ Here the defendant director took a lease on property which was then rented by his company. The latter brought suit to have it decreed that the defendant held the lease in trust for it. The theory of the plaintiff's case was that the defendant's conduct in taking the lease for himself constituted a violation of his fiduciary obligation to the plaintiff. An obviously sound decision was rendered in favor of the plaintiff. Had the director's predatory action been approved, the latter would have had the plaintiff at his mercy. He could have ousted it from the premises in question, perhaps in the interest of a competitor, or, had he so desired, he could have demanded of it an increased rental as a condition for continued use of the property. Such conduct could hardly be regarded as compatible with the high degree of loyalty which should characterize a watch-dog of the corporate interests. While it is true that the court noted that the defendant had learned of the value of the leased property as a result of his connection with the plaintiff, there can be little doubt but that the same result would have been reached even in the absence of such a showing.¹²

serious question. While it would seem clear that such cases are legitimate authority on the question of directoral duties and responsibilities (Black, *Law of Judicial Precedents* (1912) 43, 174), it must be conceded that it does not necessarily follow as a matter of so-called "realistic" jurisprudence that because a particular result was reached where the defendant was both officer and director, the identical result would have been reached if a director alone had been concerned. The writer is inclined to believe, though, that with rare, if any, exception any act on the part of a corporate officer or agent which would be regarded as violative of a fiduciary duty would be held to apply with equal, if not greater, force to the corporate director. This is because the corporate director is, in a sense, the superior of the corporate agent or officer and as such should not have, and is not likely to be permitted, any greater latitude of conduct than is permitted to the subordinate agents.

11. (1917) 227 Mass. 277, 116 N. E. 572.

12. *Acker, Merrall & Condit Co. v. McGaw* (1907) 106 Md. 536, 68 Atl. 17. Although the defendant in this case was also manager of the local office, it was not within the scope of his duties to obtain the lease renewal. See also: *M'Court v. Singers-Bigger* (C. C. A. 8, 1906) 145 Fed. 103; *Jacksonville Cigar Co. v. Dozier* (1907) 53 Fla. 1039, 43 So. 523; *Leader Publishing Co. v. Grand Trust & Savings Co.* (1915) 182 Ind. 651, 108 N. E. 121; *Robinson v. Jewett* (1889) 116 N. Y. 40 (director and president). Cf. *Steinberg v. Steinberg* (S. Ct. 1924) 123 Misc. 764, 206 N. Y. S. 134. The same result was reached where the company was bankrupt at the time the renewal was taken by the director. *Pike's Peak Co. v. Pfunter* (1909) 158 Mich. 412, 123 N. W. 19. Where, however, the lessor refused to renew plaintiff's lease and the former was not a party to the suit, it was held that the director would not be declared constructive trustee of the

The lease and other cases announce a test for determining when a director is precluded from taking advantage of an opportunity for personal profit through the acquisition of real or personal property. This rule is worth a few words as it is frequently mentioned in the opinions and purports to be general in its application. The basis for determining whether a director may take advantage of such an opportunity is said to be whether his company has an interest "actual or in expectancy" in the property involved.¹³ The interest concerned is one which is in the nature of a property interest.¹⁴ In applying this rule to the real property cases the courts have adopted the view that a company renting real estate has a property interest therein which extends beyond the expiration of its rental period or term of lease. Consequently it is asserted that a director who leases the reversion of property rented by his company comes within the prohibition of the rule, notwithstanding the fact that the company has no contractual privilege of lease renewal.¹⁵ By regarding the director's company as possessing a property interest in the reversion in these circumstances, the courts obviously have stretched the usual conception of property interests beyond the breaking-point. This was done, it is believed, in order that they might achieve what they conceived to be sound and just decisions.¹⁶ Their judgment in this respect was, in all probability, influenced by the analogy of strict trust law which holds

lease. *Jacksonville Cigar Co. v. Dozier* (1907) 53 Fla. 1039, 43 So. 523. See also: *Davis v. Pearce* (C. C. A. 8, 1928) 30 F. (2d) 85; *Pioneer Oil & Gas Co. v. Anderson* (1933) 168 Miss. 336, 151 So. 161; *Crittenden & Cowler Co. v. Cowler* (1901) 66 App. Div. 95, 72 N. Y. S. 701; *Kendall v. Webster* (1909) 14 B. C. 390. Cf. *Keech v. Sandford* [1726] Sel. Cas. Ch. 61, 25 Eng. Rep. 223.

13. See: *M'Court v. Singers-Bigger* (C. C. A. 8, 1906) 145 Fed. 103, 108; *Pike's Peak Co. v. Pfuntner* (1909) 158 Mich. 412, 123 N. W. 19, 20. See also: *Davis v. Pearce* (C. C. A. 8, 1928) 30 F. (2d) 85; *LaGarde v. Anniston Lime & Stone Co.* (1899) 126 Ala. 496, 28 So. 199, 201; *De Bardelben v. Bessemer Land & Improvement Co.* (1903) 140 Ala. 621, 37 So. 511, 514; *Zeckendorf v. Steinfield* (1909) 12 Ariz. 245; 100 Pac. 784, 790, rev'd on other grounds, (1917) 245 U. S. 445; *Colorado & Utah Coal Co. v. Harris* (1935) 97 Colo. 309, 49 P. (2d) 429, 430.

14. See: *Pike's Peak Co. v. Pfuntner* (1909) 158 Mich. 412, 123 N. W. 19, 20; *Crittenden & Cowler Co. v. Cowler* (1901) 66 App. Div. 95, 72 N. Y. S. 701, 702; *Robinson v. Jewett* (1889) 116 N. Y. 40, 53.

15. See cases cited supra notes 11 and 12.

16. In other words, the term "property interest" is deliberately used by the courts in this type of situation as a label or device to permit them to reach a desired conclusion, rather than as a reason compelling that conclusion.

that a trustee who leases a reversionary interest in property then rented for the benefit of his *cestui que trust* thereby violates his fiduciary obligation.¹⁷ And it would seem likely that the "actual or in expectancy" rule is no more than an unfortunately phrased adaptation of the trust doctrine to the directorship cases. At any rate, the rule as it is now stated should be repudiated. Its natural tendency is to promote confusion of thought and uncertainty of decision because of its unfortunate tie-up with the vague and unsatisfactory "property interest" concept.¹⁸ Furthermore, it would seem plain that the propriety of directoral conduct should not be made to turn on the presence or absence of such an interest. The basic issue—regardless of the question of property—is much broader. It is whether a person occupying the position of director—with all that word implies—*should* be permitted to take personal advantage of the particular opportunity in controversy. And whether the director *should* be permitted to do so will depend on various considerations, a number of which are suggested in this article. While it is believed, as suggested above, that the "oughtness" of the situation often has been the actual—albeit the concealed—basis which has dictated the decisions in particular cases, nevertheless the courts feign to be guided at times by the "actual or in expectancy" rule. Clearly it would be a boon if they would frankly reveal the actual, motivating forces of their judgments instead of concealing them behind a facade of counterfeit and misleading reasons.

B. Miscellaneous Situations

Related to the lease cases in basic principle is the type of situation presented in *Nebraska Power Co. v. Koenig*.¹⁹ Plaintiff company in that case was formed to construct a hydro-electric

17. *Keech v. Sandford* [1726] Sel. Cas. Ch. 61, 25 Eng. Rep. 223; *Scott, The Trustee's Duty of Loyalty* (1936) 49 Harv. L. Rev. 521. A similar result has been announced in certain principal and agent situations. *Steinberg v. Steinberg* (S. Ct. 1924) 123 Misc. 764, 206 N. Y. S. 134. See also: *Gower v. Andrew* (1881) 59 Cal. 119, 43 Am. Rep. 242; *Davis v. Hamlin* (1883) 108 Ill. 39. The fact that the conduct of both agents and trustees is condemned where they obtain leases for themselves would seem to supply additional support for a similar conclusion where directors are involved, as the underlying policies which dictate that such conduct should be condemned where the former are concerned would seem to apply with equal force to the latter.

18. See *McClain, Injunctive Relief Against Employees Using Confidential Information* (1935) 23 Ky. L. J. 248, 253.

19. (1913) 93 Neb. 39, 139 N. W. 839.

power plant. The defendant, who had served on plaintiff's staff of engineers, was also a member of plaintiff's board of directors. The defendant brazenly filed a personal application for the diversion of water at a location above the plaintiff's project. This application, if granted, would have had the effect of "injuring if not destroying" the plaintiff's project. The court reached the obviously sound conclusion that the director was guilty of disloyalty to his company's interests by making the application and that as a consequence it should be deemed made in trust for it.²⁰ Among various reasons assigned for the decision was the one that the defendant's managerial status prevented him from acquiring a water right in the stream used by his company which was adverse to the latter's interests. It would seem to be implicit in this holding that a director will not be permitted to take any action in his private interest which has the natural and calculated effect of causing a substantial injury to his company.²¹

APPROPRIATION BY A DIRECTOR OF A BUSINESS OPPORTUNITY
WHICH IS NOT WITHIN THE SCOPE OF A FORMULATED
CORPORATE OBJECTIVE

A. In General

A director may so conduct his personal business activities that, while they in no way conflict with any formulated objective of his company, they are inconsistent with some of the purposes and powers conferred on the company by its charter.²² The prob-

20. Accord: *Hussong Dyeing Machine Co. v. Morris* (1913) 81 N. J. Eq. 256, 89 Atl. 249. See also: *American Circular Loom Co. v. Wilson* (1908) 199 Mass. 182, 84 N. E. 133; *Southwest Pump & Machinery Co. v. Forslund* (1930) 225 Mo. App. 262, 29 S. W. (2d) 165. A contrary result was reached, however, where the company concerned had failed of its purpose and was both dormant and insolvent at the time of the director's action. *Jasper v. Appalachian Gas Co.* (1913) 152 Ky. 68, 153 So. 50 (director and president). See, however, *Pike's Peak Co. v. Pfunter* (1903) 158 Mich. 412, 123 N. W. 19 (director and corporate office-holder).

21. It is stated both in *Nebraska Power Co. v. Koenig* (1913) 93 Neb. 39, 139 N. W. 839, and in *Hussong Dyeing Machine Co. v. Morris* (1913) 81 N. J. Eq. 256, 89 Atl. 249, that the information concerning the value of the opportunities there involved was obtained in whole or in part as a result of the director's connection with the company involved. Both opinions indicate, however, that the result would have been the same even though the information had not been so obtained.

22. In *Greer v. Stannard* (1929) 85 Mont. 78, 277 Pac. 622, 627, the court indicated, in passing on the propriety of directoral conduct in taking advantage of particular business opportunities, that the primary purpose of the enterprise controls rather than the wide powers and purposes conferred on the company by its corporate charter. See also *Lancaster Loose*

lems arising from such activities may be divided into two general classes. The first class involves the acquisition by a director of various types of real or personal property, exclusive, however, of obligations of his own company; the second class, the acquisition by a director of such company obligations.

*Tierney v. United Pocahontas Coal Co.*²³ is typical of the first class of cases. Here a shareholder brought a representative suit for the benefit of a company which was engaged in the business of mining coal. The defendant, who was one of plaintiff's directors, purchased a tract of coal land situated near the fields of his company.²⁴ This property could have been conveniently and advantageously used and operated by the coal company. It was contended on behalf of the latter that the director violated his fiduciary obligation by acquiring the land for himself and that as a consequence it should be regarded as held in trust for it. The court held, and very properly so, that the director was guilty of no improper conduct. It is significant that there was no evidence to establish either that the company was in the market for the land concerned or that its acquisition had any important bearing on the ability of the enterprise to function. The conclusion to be drawn from this and similar cases is that the courts are likely to be extremely reluctant to hold that a director who purchases property in such circumstances violates a duty to his company.²⁵ This idea has been expressed in *LaGarde v. Anniston*

Leaf Tobacco Co. v. Robinson (1923) 199 Ky. 313, 250 S. W. 997, 999. *A fortiori* a director may take advantage of opportunities which are *ultra vires* the corporate powers and purposes. Cf.: *Barr v. Pittsburgh Plate Glass Co.* (C. C. W. D. Pa. 1892) 51 Fed. 33, aff'd (C. C. A. 3, 1893) 57 Fed. 86; *Thilco Timber Co. v. Sawyer* (1926) 236 Mich. 401, 210 N. W. 204. But see *Young v. Columbia Oil Co.* (1930) 110 W. Va. 364, 158 S. E. 678, referred to *infra* note 56.

23. (1920) 85 W. Va. 545, 102 S. E. 249. Cf.: *Zeckendorf v. Steinfield* (1909) 12 Ariz. 245, 100 Pac. 735, rev'd on other grounds (1912) 225 U. S. 445; *Blair Town Lot & Land Co. v. Walker* (1879) 50 Iowa 376; *Beaudette v. Graham* (1929) 267 Mass. 27, 165 N. E. 671; *Burland v. Earle* [1902] A. C. 83.

24. There is no indication that the acquisition of coal lands was part of the ordinary business of the company. If that had been true, a different result might be indicated, because the director's purchase of the property might have been construed as an interference with a formulated objective of the company. See *infra*, page 202.

25. Accord: *Lancaster Loose Leaf Tobacco Co. v. Robinson* (1923) 199 Ky. 313, 250 S. W. 997 (corporate president); *Lawrence v. Sutton-Zwolle Oil Co.* (1939) 193 La. 118, 190 So. 351. Cf. *Pine v. White* (1900) 175 Mass. 585, 56 N. E. 967. The case for upholding such a purchase by a director would be especially clear where the corporation was dormant and the property concerned had been either forfeited or abandoned by the latter. *McDermott Mining Co. v. McDermott* (1902) 27 Mont. 143, 69 Pac. 715.

Lime & Stone Co.,²⁶ where it was said that "good faith to the corporation does not require of its officers that they steer from their own to the corporation's benefit enterprises or investments which, though capable of profit to the corporation, have in no way become the subjects of their trust or duty." While it might be contended that the "punctilio of an honor most sensitive" could be satisfied only through the director's offering such an opportunity to his company before he took personal advantage of it, nevertheless it would also seem to be true that such directoral conduct can well be tolerated within the framework of a workable and satisfactory code of corporate ethics.

*B. Acquisition by a Director of Obligations Owning by His Company to Third Persons*²⁷

The restrictive consequences of the directorship status may also arise where a director acquires claims owing by his own company. This question may arise in a variety of circumstances. Here we shall consider the situation presented where a director buys a claim owing by his company at a time when the latter has no formulated project for its acquisition.

1. *Purchase of claims at par.* The courts appear to be largely agreed that a director who purchases a liquidated obligation of his company at par thereby violates no duty owing to his company.²⁸ He is entitled to enforce the claim according to its tenor, even though the opportunity for its acquisition was not first offered to the debtor. While it is true that directoral ownership of such obligations in some situations may give rise to a clash between the personal interests of the claim-holder and those of the debtor,²⁹ the courts apparently have proceeded on the assumption that the advantages flowing from the approval of such transactions outweigh the possible disadvantages. This point of view may be influenced by the fact that a director who has purchased a company obligation at par obtains no profits at the expense

26. (1900) 126 Ala. 496, 28 So. 199.

27. Situations involving the purchase of obligations directly from the issuing company are not herein considered.

28. 2 Thompson, *Corporations* (3d ed. 1927) 1121, sec. 1522. The cases which permit purchases of securities at a discount are *a fortiori* authority for this statement. See note 34, *infra*.

29. It may, for example, be to the company's advantage to attempt to obtain an extension of its debt at maturity. A director owning such claims might, however, conceive it to his advantage to press for immediate payment.

of the debtor when the obligation is paid, while company creditors from whom the purchase was made receive the face amount of their claims. Then, too, the company may benefit from such purchases not only as a result of the additional stake which the director thereby obtains in the business, but through the obvious advantage accruing to it where it is generally known that corporate insiders have sufficient faith in its future to put their own money into its obligations.

2. *Purchase of claims below par.*³⁰ Where, however, the claim acquired by a director is one which was purchased at less than par, a significantly different problem is presented. In some jurisdictions strong indications are to be found that a director is absolutely precluded from collecting from his company more than he paid for the claim.³¹ In these jurisdictions it is suggested that the situation is controlled by the analogy of strict trust law which prevents the trustee from profiting from the purchase of trust obligations.³² Probably the underlying reason for the result indicated is that a contrary view might tempt corporate officers to manipulate the corporate affairs and financial statements in such a way as to enable them to acquire company obligations at artificially depressed prices.³³

30. The claim concerned may, of course, be unliquidated. A royalty contract usually would be of this type. *Farwell v. Pyle-National Electric Headlight Co.* (1919) 289 Ill. 157, 124 N. E. 449, is a case in which the director of a corporation acquired a royalty contract, apparently for less than its full value, at a time when the company was in a position to buy the contract itself. A disagreement over the interpretation of the agreement had developed between the company and the previous owner. It was held that the director violated his fiduciary duty to his company by purchasing the agreement in these circumstances.

31. See: *Davis v. The Rock Creek L. F. & M. Co.* (1880) 55 Cal. 359, 364; *Lingle v. National Ins. Co.* (1869) 45 Mo. 109 (president); *The Chouteau Ins. Co. v. Floyd* (1881) 74 Mo. 286, 291 (director regarded as trustee); *Brewster v. Stratman* (1877) 4 Mo. App. 41 (president); *Duncomb v. New York H. & N. Ry.* (1881) 84 N. Y. 190, 202; *McDonald v. Haughton* (1874) 70 N. C. 393, 399; *Hill v. Frazier* (1853) 22 Pa. St. 320 (treasurer). 3 Cook, *Corporations* (8th ed. 1923) 2520, sec. 660.

32. See cases cited supra note 31. See also 1 Perry, *Trusts* (7th ed. 1929) 712, sec. 428; Scott, *The Trustee's Duty of Loyalty* (1936) 49 Harv. L. Rev. 521, 556.

33. Cf.: *The Chouteau Ins. Co. v. Floyd* (1881) 74 Mo. 286, 291; *McDonald v. Haughton* (1874) 70 N. C. 393, 399. But where, under state insolvency statutes, a company is placed in receivership for the purpose of dissolution and liquidation, a director's relation to his company ceases and he may thereafter purchase corporate claims at a discount and obtain a *pro rata* share of the involvent's assets. In *re Allen-Foster-Willett Co.* (1917) 227 Mass. 551, 116 N. E. 875; *Hammond's Appeal* (1889) 123 Pa. St. 503 (director and treasurer). Cf. *Stanton v. Gilpin* (1905) 38 Wash.

In the larger number of states, on the other hand, it is assumed that the existence of the directoral status alone does not of itself preclude a director from collecting the face amount of corporate claims which he has purchased at a discount.³⁴ This point of view should not, however, be understood as giving the corporate director the same free hand in connection with the purchase of corporate claims that he would have were it not for his position. For example, the director's opportunity to acquire company obligations may arise when the latter is financially able to buy them in and when it would be in its best interests to do so, even though it then had no formulated plan for acquiring or retiring them prior to their maturity. An opportunity presented to a director under these conditions would, of course, give rise to a direct conflict between the director's personal interest in buying the obligations at a discount and that of his company in retiring its debts for less than their face amount. The majority of cases in which this question has been considered directly or by way of dictum indicate that a director buying claims in these circumstances may not enforce them for more than their cost to him.³⁵

191. But the court in the Allen-Foster-Willett case, *supra*, at p. 886, intimated that the result would have been *contra* if the receivership proceedings had not ousted the directors from their office.

34. Camden Trust Co. v. Citizens Ice & Cold Storage Co. (1905) 69 N. J. Eq. 713, 61 Atl. 529; McIntyre v. Ajax Mining Co. (1904) 28 Utah 162, 77 Pac. 613; Glenwood Mfg. Co. v. Syme (1901) 109 Wis. 355, 85 N. W. 432. See: Inglehart v. Thousand Island Hotel Co. (N. Y. 1884) 32 Hun. 377; Seymour v. Spring Forest Cemetery Ass'n (1895) 144 N. Y. 333, 39 N. E. 365; Hauben v. Morris (1938) 255 App. Div. 35, 5 N. Y. S. (2d) 721. Cf. Harts v. Brown (1875) 77 Ill. 226; Higgins v. Lansingh (1895) 154 Ill. 301, 384, 40 N. E. 362; Farwell v. Pyle-National Electric Headlight Co. (1919) 289 Ill. 157, 124 N. E. 449; St. Louis, F. S. & W. R. R. v. Chenault (1886) 36 Kan. 51, 12 Pac. 303 (director and treasurer). See also Todd v. Temple Hospital Ass'n (1928) 96 Cal. App. 42, 273 Pac. 595. It has been held, though, that a director who acquires a corporate claim at a time when his company is insolvent may not participate in the distribution of company assets for more than he paid for the claim. Bonney v. Tilley (1895) 109 Cal. 346, 42 Pac. 439. See Horner v. New South Oil Mill (1917) 130 Ark. 551, 197 S. W. 1163, 1165.

35. The Telegraph v. Lee (1904) 125 Iowa 17, 98 N. W. 364 (obligation past due, but this fact apparently not regarded as important by the court); Wabunga Land Co. v. Schwanbeck (1929) 245 Mich. 505, 222 N. W. 707 (managing director). See also: Harts v. Brown (1875) 77 Ill. 226; Farwell v. Pyle-National Electric Headlight Co. (1919) 289 Ill. 157, 165, 124 N. E. 449; Punch v. Hipolite Co. (1936) 340 Mo. 53, 100 S. W. (2d) 878; Glenwood Mfg. Co. v. Syme (1901) 109 Wis. 355, 85 N. W. 432. And seemingly a company need not have the cash if it has the credit. See: Martin v. Chambers (C. C. A. 5, 1914) 214 Fed. 769, 771; Wabunga Land Co. v. Schwanbeck, *supra*; Higgins v. Lansingh (1895) 154 Ill. 301, 386, 40 N. E. 362, 387; Punch v. Hipolite Co., *supra*. It was suggested, however, in Sey-

The foregoing point of view is sometimes justified on the basis that a director, as a corporate fiduciary,³⁶ is charged with the duty of conserving the monetary welfare³⁷ of his company, and sometimes on the basis that he will not be permitted to profit at the expense of his company where, as in this situation, there is a direct clash between his personal interest and that of "other stockholders."³⁸ A composite interpretation of these views is that the courts believe it unfair to allow directors to profit from such purchases where their company was able to buy the claims and it was in its best interests to do so.³⁹ Of course, if the company was unable to make the purchase⁴⁰ or if it had decided to do nothing about debt retirement before maturity, the acquisi-

mour v. Spring Forest Cemetery Ass'n (1895) 144 N. Y. 333, 39 N. E. 365, 367, that no such duty exists unless a specific fund has been set up or liquidation has been ordered. In *Young v. Columbia Land & Inv. Co.* (1909) 53 Ore. 438, 99 Pac. 936, rehearing denied (1909) 53 Ore. 445, 101 Pac. 212, it was held that controlling directors violated their fiduciary duties by taking claims originally offered to their company, even though the latter had no plan for their acquisition.

It has been asserted that while a director may not profit from the enforcement of a claim of his company which he purchased at a discount after maturity, no such broad rule applies to unmatured claims. Whether a director violates his fiduciary obligation by acquiring the latter type of claim without first offering the opportunity to his company, is said to depend on the facts of the particular case. *Riley, Corporation's Right to Profits Made by Directors* (1920) 4 Minn. L. Rev. 513, 519. Apparently the philosophy of this point of view as it applies to matured claims is that directors should be required to conduct the affairs of their companies so that ordinary creditors will, where possible, receive the full payment of their claims. Apparently the fear is that if directors are permitted to profit through the acquisition of matured claims, they will have an incentive deliberately to withhold their payment at maturity in order to buy them in at a discount. Assuming this point of view to be sound, it is difficult to understand why it should be limited to matured claims. It would seem equally objectionable that directors should have the incentive, which would exist where unmatured claims are concerned, to present the corporate financial picture in the least favorable light in order that they might also be enabled to purchase that class of claims at a discount.

36. See *The Chouteau Ins. Co. v. Floyd* (1881) 74 Mo. 286.

37. See *In re Allen-Foster-Willett Co.* (1917) 227 Mass. 551, 116 N. E. 875, 876.

38. See: *Davis v. The Rock Creek L. F. & M. Co.* (1880) 55 Cal. 359, 364; *The Telegraph v. Lee* (1904) 125 Iowa 17, 98 N. W. 364; *Lingle v. National Ins. Co.* (1869) 45 Mo. 109, 110 (corporate president). Cf. *McDonald v. Houghton* (1874) 70 N. C. 393.

39. He would, however, be permitted to collect the amount paid for the claim. *Bonney v. Tilley* (1895) 109 Cal. 346, 42 Pac. 439; *In re McCrory Stores Corp.* (D. C. S. D. N. Y. 1935) 12 F. Supp. 267; *Hill v. Frazier* (1853) 22 Pa. St. 320 (treasurer). See also *Restatement, Restitution* (1937) sec. 194.

40. *Punch v. Hipolite Co.* (1936) 340 Mo. 53, 100 S. W. (2d) 878. See also *Glenwood Mfg. Co. v. Syme* (1901) 109 Wis. 355, 85 N. W. 432. But see note 54, *infra*.

tion of the claims below par would be regarded as unobjectionable.⁴¹ It would also seem clear as a general proposition that if an opportunity of this or any other type is first offered to the company and *bona fide* refused by it, a director may take advantage of it thereafter without violating his fiduciary obligation.⁴² And presumably a director's acquisition of claims below par, where the securities concerned were traded on the open market, would be unobjectionable, because in such circumstances the corporation would have the same opportunity to acquire them as the director himself.

In considering the consequences of a director's acquisition of real or personal property other than corporate claims, it was previously noted that he is not required to offer such opportunities to his company if the latter has no project afoot for the purchase of the property nor any compelling reason for buying it, even though such acquisition might be advantageous to it.⁴³ It may be urged that in so differentiating between corporate obligations and other types of property, the law has taken an illogical and unsatisfactory turn. While this view might seem superficially true, there are nevertheless important elements distinguishing the situations. Where claims are concerned, the company has a definite and legally enforceable duty, namely, their ultimate acquisition (payment at maturity). The continuous interest which a company normally manifests in its own obligations, together with its ultimate objective of payment, obviously make a stronger case for requiring a director to offer this type of opportunity to his company than is true where other types of property are concerned. Then, too, the case for distinctive treatment becomes even stronger when there is added to the foregoing considerations the undesirable consequences which may accompany what would otherwise be a virtually unlimited privilege on the part of directors to speculate in the securities of their own company.⁴⁴

41. *DuPont v. DuPont* (C. C. A. 3, 1916) 256 Fed. 129; *Sandy River R. R. v. Stubbs* (1885) 77 Me. 594; *Thilco Timber Co. v. Sawyer* (1926) 236 Mich. 401, 210 N. W. 204. Cf. *Presidio Mining Co. v. Overton* (C. C. A. 9, 1919) 261 Fed. 933.

42. Accord: *Sandy River R. R. v. Stubbs* (1885) 77 Me. 594. Cf. *Lang Soap Co. v. Ward* (Tex. Civ. App. 1925) 269 S. W. 851 (corporate manager).

43. See *supra*, page 195.

44. Legislative recognition of the undesirability of affording directors too broad a field for speculating in the securities of their own companies is to be found in the Securities and Exchange Act of 1934, sec. 16, which

ACQUISITION BY A DIRECTOR OF PROPERTY FALLING WITHIN A
FORMULATED OBJECTIVE OF HIS COMPANY.⁴⁵

*A. Where Acquisition of the Particular Property Forms
an Initial Objective of a Newly Formed Company.*

A primary objective of a newly formed company frequently will be the purchase of particular items of real or personal property, and the future of the enterprise may hinge on the outcome of its efforts in this connection.⁴⁶ The inability of a company, for example, to acquire a patent necessary for the type of manufacturing activity which it was formed to engage in, might well spell the doom of the enterprise. The question of whether a director violates his fiduciary obligation if he thwarts his company's objective by buying such property for himself may be considered with reference to one of the various rules advanced as a basis for determining such problems. According to one rule the propriety of directoral conduct of this type is to be judged by whether or not the latter was authorized to act for his company with respect to the particular opportunity concerned.⁴⁷ Its application to the facts suggested would seemingly exonerate the director of any breach of duty because of his lack of authority to act for his company in obtaining the property concerned.⁴⁸ To say the least, such a result would be startling. The corporate watch-dog certainly should not be permitted to engage in such

makes it unlawful for directors subject to that Act to profit from the purchase and sale of company securities which they have held for less than six months.

45. No attempt is made herein to consider whether a director having an opportunity to buy stock in his own company must first offer the opportunity to his company. See: *DuPont v. DuPont* (C. C. A. 3, 1919) 256 Fed. 129; *Bisbee v. Midland Linseed Products Co.* (C. C. A. 8, 1927) 19 F. (2d) 24; *Holmes v. Doe Run Lead Co.* (Mo. App. 1920) 223 S. W. 772; *Stanton v. Schenck* (S. Ct. 1931) 140 Misc. 621, 251 N. Y. S. 221; *Hauben v. Morris* (1938) 255 App. Div. 35, 5 N. Y. S. (2d) 721.

46. In *Blake v. Buffalo Creek R. R.* (1874) 56 N. Y. 485, 490, the court said that it was an essential part of the duty of corporate directors to aid in the acquisition of such property. See also: *American Circular Loom Co. v. Wilson* (1908) 199 Mass. 182, 84 N. E. 133, 137; *Nebraska Power Co. v. Koenig* (1913) 93 Neb. 38, 139 N. W. 839, 843.

47. *Carper v. Frost Oil Co.* (1922) 72 Colo. 345, 211 Pac. 370; *Colorado & Utah Coal Co. v. Harris* (1935) 97 Colo. 309, 49 P. (2d) 429, 430; *Comment* (1913) 13 Col. L. Rev. 431; 3 *Fletcher, Corporations* (Perm. ed. 1931) 175-176, sec. 862.

48. The same would always be true where the director concerned had no other relation with his company—as, for example, officer or agent—because the individual director has no authority to act for his company save as a member of the directorate. See note 7, *supra*.

personal foraging when, as in the circumstances under consideration, the consequences would be so disastrous to the very interests he was supposed to promote. It is hardly surprising, therefore, that the rule above referred to—if it can be dignified by that terminology—has been ignored in this type of situation. A director who buys property for himself in these circumstances is held to have violated his fiduciary obligation.⁴⁹

B. Acquisition by a Director of Property Which was a Post-Incorporation Objective of His Company

Another problem concerns a director's purchase for himself of property which was a post-incorporation objective of his company. The property so bought may range from the tangible to the intangible, from a proposed business site to a patent desired by his company. If he should take advantage of confidential information in making such a purchase, there can be little doubt but that his conduct would be held to constitute a violation of his fiduciary obligation.⁵⁰ The situation concerned may, however, be one where the director acts without taking advantage of any such information. While his purchase of property forming a post-incorporation objective of his company might not have the same serious consequences which frequently would attend his acquisition of property forming an initial objective of the enterprise,⁵¹ nevertheless the situation is one which involves an extreme instance of infidelity to corporate interests on the part of one whose duty it was to promote and not defeat those interests. A mere statement of such conduct on the part of a director would seem sufficient to condemn it.⁵² This conclusion would, however, overlook the "actual or in expectancy" rule already considered. This rule, it will be recalled, purports to test the propriety of directoral conduct in acquiring real or personal property by whether his company possesses an interest, actual or in expect-

49. *Averill v. Barbour* (1889) 53 Hun. 636, 6 N. Y. S. 255 (directors held liable for profits). See also: *Des Moines Terminal Co. v. Des Moines Union Ry.* (C. C. A. 8, 1931) 52 F. (2d) 616, 633; *Goldenrod Mining Co. v. Burvich* (1939) 108 Mont. 569, 92 P. (2d) 316. Cf. *LaGarde v. Anniston Lime & Stone Co.* (1900) 126 Ala. 496, 28 So. 199; *Colorado & Utah Coal Co. v. Harris* (1935) 97 Colo. 309, 49 P. (2d) 429; *Lake v. Buffalo Creek R. R.* (1874) 56 N. Y. 485.

50. *Girard Co. v. Lamoureux* (1917) 227 Mass. 271, 116 N. E. 572. See also *In re McCrory Stores Corp.* (D. C. S. D. N. Y. 1935) 12 F. Supp. 267.

51. See *supra*, page 201.

52. This point of view assumes, of course, a live corporate project.

ancy, in the property at the time of his purchase. Clearly neither a mere corporate objective involving the acquisition of certain property nor negotiations looking toward that end can be properly regarded as giving the company a technical property interest in the subject of the director's purchase, at least if the term "property" is accorded its usual meaning.⁵³ Hence the "actual or in expectancy" rule, if applied, would seem to leave the director free to buy property which his company was then seeking. It is difficult to believe, though, that this conclusion would be reached in any well-considered decision.⁵⁴ The case against the director where, as here, he interferes with a formulated corporate objective by purchasing property sought by his company certainly is stronger than where no such objective exists, and decisions are to be found which denounce directoral purchases in the latter situation.⁵⁵ It is believed that it may be safely assumed that the courts sufficiently appreciate that the very foundation-stone of the corporate institution, namely, investor confidence in the honesty and integrity of corporate managers, would receive a severe blow if judicial approval were to be placed on directoral philandering of the type here considered. Fortunately there are expressions in the cases which support this latter point of view.⁵⁶

53. See: *LaGarde v. Anniston Lime & Stone Co.* (1900) 126 Ala. 496, 28 So. 199, 201; *Colorado & Utah Coal Co. v. Harris* (1935) 97 Colo. 309, 49 P. (2d) 429; *Pioneer Oil & Gas Co. v. Anderson* (1933) 168 Miss. 334, 151 So. 161, 163. But see *De Bardelben v. Bessemer Land & Improvement Co.* (1904) 140 Ala. 621, 37 So. 511, 514.

54. A director of a solvent company desiring to acquire certain property violates no duty by acquiring property which the company was financially unable to buy. *Hannerty v. Standard Theatre Co.* (1892) 109 Mo. 297, 19 S. W. 82 (director and president). Cf. *Zeckendorf v. Steinfield* (1909) 12 Ariz. 245, 100 Pac. 784, rev'd on other grounds (1912) 225 U. S. 445. This view, however, was seriously criticized in *Irving Trust Co. v. Deutsch* (C. C. A. 2, 1934) 73 F. (2d) 121, on the theory that if it were permitted to prevail, directors might thereby be tempted to refrain from using their best efforts on behalf of their company. See also Note (1935) 2 U. of Chi. L. Rev. 323. Cf. *Green v. Hall* (Tex. Com. App. 1921) 228 S. W. 183; *McKee v. Swenson* (1925) 232 Mich. 505, 205 N. W. 583.

55. See *supra*, pages 190 and 196.

56. See: *Zeckendorf v. Steinfield* (1909) 12 Ariz. 245, 100 Pac. 784, 790, rev'd on other grounds (1912) 225 U. S. 445; *Highland Park Inv. Co. v. Lynn* (1919) 27 Cal. App. 761, 184 Pac. 48, 49; *Goldenrod Mining Co. v. Burvich* (1939) 108 Mont. 569, 92 P. (2d) 316, 320. Cf. *In re McCrory Stores Corp.* (D. C. S. D. N. Y. 1935) 12 F. Supp. 267. In *Young v. Columbia Oil Co.* (1930) 110 W. Va. 364, 158 S. E. 678, the court went so far as to hold that an opportunity to buy certain property which the company desired but which it could not legally own should be offered to the shareholders before the directors could buy the property for themselves. But see

It has been assumed in the situation above considered that the property concerned was purchased by a director at a time when he was fully advised that his company also was attempting to buy it. Any lack of knowledge of such plan on his part should not, however, alter the result. It would be highly undesirable that a premium should be put on directoral inattention by making it more profitable for a director to be ignorant than to be informed.

A more difficult question arises where a company, without having decided on the specific unit of property to be purchased, nevertheless lays general plans to acquire a certain type or class of real or personal property and desirable property within such class is purchased by a director. No all-inclusive rule can be laid down as a guide in this situation. Individual cases will hinge, among other things, on the degree with which details have been worked out concerning the plan and type of property desired. Vague and essentially undefined plans or projects should not ordinarily prevent directors from profiting from the acquisition of property which might fall within their scope.⁵⁷ A contrary result would seem sound, however, if the property sought and the plan for its acquisition were defined with reasonable certainty and the director substantially narrowed the range of the company's selection by buying property which was suitably located and particularly adaptable to its needs. It would seem unsound that the corporate interests should be sacrificed for the director's personal profit in such circumstances.⁵⁸

Thilco Timber Co. v. Sawyer (1926) 236 Mich. 401, 210 N. W. 204. It is also undoubtedly true that directors may not direct to themselves business opportunities which would normally go to their corporation. See: *Coleman v. Hanger* (1925) 210 Ky. 309, 275 S. W. 784; *Chicago Flexotile Floor Co. v. Lane* (1933) 188 Minn. 422, 247 N. W. 517; *Cook v. Deeks* [1916] 1 A. C. 554.

57. See: *Carper v. Frost Oil Co.* (1922) 72 Colo. 345, 211 Pac. 370; *Colorado & Utah Coal Co. v. Harris* (1935) 97 Colo. 309, 49 P. (2d) 429. The court in the *Harris* case, *supra*, p. 431, went so far as to state that directors buying property in such circumstances may take advantage of corporate data and information relating to the particular property concerned. See also *LaGarde v. Anniston Lime & Stone Co.* (1900) 126 Ala. 496, 28 So. 199, 201.

58. The Restatement of the Law of Agency, section 393, at comment b, in an analogous situation, takes the position that an agent employed to purchase unspecified goods in the open market is permitted to purchase goods of the same kind for himself, if the purchase does not affect the price or prevent the required amount from being purchased for his principal. The considerations dictating this result would seem to apply in an important measure to directors acting in analogous situations.

PURCHASE BY A DIRECTOR OF PROPERTY WHICH HIS COMPANY
UNSUCCESSFULLY HAS ATTEMPTED TO BUY

Whether a director should be permitted to act on his own behalf with respect to property which his company has unsuccessfully attempted to buy is a further problem which does not admit of categorical answer. In *LaGarde v. Anniston Lime & Stone Co.*⁵⁹ the plaintiff brought suit against certain of its directors and officers to have it decreed that the latter held a third interest in a stone quarry for plaintiff's benefit. The plaintiff itself, which operated the quarry in question, had unsuccessfully attempted to acquire the interest from its then owners. After plaintiff's negotiations for the property had collapsed, the defendant, one of plaintiff's directors, acquired the interest in question. Judgment was rendered for defendant on the theory that he was entitled to act for himself in the circumstances of the case. Although reasonable minds may differ as to the soundness of this conclusion, it does not seem that the judgment is open to very serious objection if certain language in the opinion is disregarded and the holding is confined to the precise facts of the case.

It is probable that the actual decision may be explained on a purely technical basis. Evidence was lacking in the case to show that the company intended to resume negotiations for the acquisition of the property.⁶⁰ It may even have used available resources in other ways. If, however, evidence had been introduced in the case which established that the project for acquisition of the property had remained in force, a significantly different decision might well have been reached. Certainly if negotiations had failed on the score of price and the company intended to re-open them at an increased figure, the director would not have been advancing its best interests with the high degree of honesty which he should display, if he bought the property for himself in such circumstances.⁶¹ And even though the evidence

59. (1900) 126 Ala. 496, 28 So. 199. See also *Pioneer Oil & Gas Co. v. Anderson* (1933) 168 Miss. 334, 151 So. 161.

60. For a somewhat analogous case holding that the director of a dormant corporation may obtain good title to a company mining claim which the latter abandoned or forfeited, see *McDermott Mining Co. v. McDermott* (1902) 27 Mont. 143, 69 Pac. 715.

61. A director violates no duty to his company by acquiring property which the owner refused to sell to his company. *Pioneer Oil & Gas Co. v. Anderson* (1933) 168 Miss. 334, 151 So. 161; *Crittenden & Cowler Co. v.*

should show, as would often be true, that the company's intention was nebulous, no definite decision having been reached with respect to whether or not negotiations would be re-opened, a director who acquired the property for himself before a sufficient time had elapsed to justify the presumption of an abandonment of the project, certainly would not be observing the code of ethics required of one in his position.

EFFECT OF ACQUISITION BY A DIRECTOR OF PROPERTY BOUGHT
FOR PURPOSE OF RESALE TO HIS COMPANY

It should be clear from the foregoing discussion that while a director's status restricts the orbit of his personal business activities in some measure, nevertheless there remains a wide area of possible business activities which are in no way affected by his corporate affiliation. Ordinarily, therefore, no problem is raised where a director confines his activities to this unrestricted area. A special situation may, however, be presented, even though he operates in what ordinarily would be the unrestricted area, where the director takes advantage of a particular business opportunity with an eye to reselling the subject-matter thereof to his company. Where property is so acquired and sold, one aspect of the transaction is the familiar one involving a sale of property by a fiduciary to his principal. Under the majority view a director's sale of property to his company will be upheld where the terms of the agreement are both fair and have received the approval of a disinterested majority of the company's board of directors.⁶² However, if the sale is not so approved, or even though it is approved in this manner, it is voidable at the option of the company if it is made on unfair terms.⁶³

The question arises as to whether the foregoing rules establish the full measure of relief to which a company is entitled where it has bought property from a director who acquired it for the express purpose of such sale. If these rules afford the complete relief to which the company is entitled, it could at most rescind the sale where the terms were unfair or where it had not been

Cowler (1901) 66 App. Div. 95, 72 N. Y. S. 701; Kendall v. Webster (1909) 14 B. C. 390 (managing director). Cf.: Bisbee v. Midland Linseed Products Co. (C. C. A. 8, 1927) 19 F. (2d) 24; Hauben v. Morris (1938) 255 App. Div. 35, 5 N. Y. S. (2d) 721. See also note 12, *supra*.

62. Stevens, *Corporations* (1936) 534.

63. Ballantine, *Corporations* (1927) 391.

properly authorized. Superficially, at least, this might seem to provide all the protection the company could legitimately ask for, the argument being that, if the contract is proved unfair or not properly authorized, the company may avoid it. And so, this line of argument would continue, if the terms of the agreement are fair and the sale properly authorized, no sufficient reason would seem to exist for not regarding the company as bound by its bargain. This point of view, however, is more plausible than sound. If directors should be permitted to profit through the sale to their companies of property which they acquired for that express purpose, they would be continually subjected to the unwholesome temptation of stifling beneficial managerial suggestions until they were in a position to benefit personally from them. Even where the unfairness of the sale could be demonstrated, the company could only rescind the agreement, thereby returning the property concerned to the director. It could not, under the rules above discussed, both retain the property—which might be very useful to it—and require the director to account to it for any profit he might have made on the deal.⁶⁴ The few decisions on the point hold that a director may be made to account for any profit made on property sold to his company which was bought for that purpose.⁶⁵

AFFILIATION OF A DIRECTOR WITH A COMPETITIVE BUSINESS

There is little helpful authority on the extent to which the directorship status limits or restricts the director's privilege of becoming associated with a competitive business.⁶⁶ Most judicial pronouncements on the subject seem to have stemmed from two

64. *Burland v. Earle* [1902] L. R. App. Cas. 83. See also *New York Trust Co. v. American Realty Co.* (1926) 244 N. Y. 209, 155 N. E. 102.

65. *Higgins v. Lansingh* (1895) 154 Ill. 301, 40 N. E. 362; *Bliss Petroleum Co. v. McNally* (1931) 254 Mich. 569, 237 N. W. 53. Cf.: *Kroeger v. Calivada Colonization Co.* (C. C. A. 3, 1902) 119 Fed. 641; *McKey v. Swenson* (1925) 232 Mich. 505, 205 N. W. 583; *Hampden Trust Co. v. Citizens Ice & Cold Storage Co.* (1905) 69 N. J. Eq. 718, 61 Atl. 529; *Gilmore v. W. J. Gilmore Drug Co.* (1924) 279 Pa. 193, 123 Atl. 730. A somewhat analogous situation is that involved where corporate promoters acquire property for the purpose of transfer to a corporation thereafter to be formed. It has been held that if their plan contemplates a sale by the company of its shares, they become liable to it for secret profits made from the transfer of such property. *Old Dominion Copper Co. v. Lewisohn* (1907) 210 U. S. 206.

66. It is, of course, possible that association with a competitive company would be grounds for removal from office. See *Spellman, Corporate Directors* (1931) sec. 108.

cases. The first, *New York Automobile Co. v. Franklin*,⁶⁷ involved a suit to require defendant, one of plaintiff's directors, to account for certain profits which were alleged to have been earned by defendant through a violation of his directoral obligation. Plaintiff had been organized to manufacture automobiles, but its inability to raise the required capital prevented it from fulfilling its objective. During the period of his affiliation with plaintiff, defendant became associated with another automobile enterprise which proved to be very successful. Plaintiff's suit was premised on the theory that defendant breached his fiduciary duty by becoming associated with the other enterprise. Judgment was rendered for defendant. This result seems open to no serious objection since it was not shown that defendant's conduct interfered with any interest of the plaintiff which had developed sufficiently to warrant judicial protection. Because of its inability to raise the required capital plaintiff had never actually commenced business, and no connection was shown between plaintiff's failure in this connection and defendant's conduct.

The second case, *Barr v. Pittsburgh Glass Co.*,⁶⁸ involved a company which was engaged in the manufacture of glass. This case arose during the early days of the plate glass industry and at a time when plaintiff's plant was taxed to capacity and orders were on the increase. An individual named Ford, who was owner of a large block of plaintiff's stock, decided that the glass industry had such excellent prospects that it would pay him to launch a second enterprise. Defendant Pitcairn, who was a director of plaintiff and who had a large financial interest in plaintiff company, attempted to dissuade Ford from the project but was unsuccessful. Thereafter Pitcairn took an interest in the new enterprise in order to prevent it from falling into unfriendly hands. Before so doing he obtained the approval of several of plaintiff's principal stockholders. Before the new plant was completed, plaintiff reversed its policy of non-expansion and acquired the new enterprise from the defendant and its other owners. Plaintiff then sought to recover the profit made by defendant through the sale on the theory that he had violated his fiduciary relationship by becoming associated with the new enterprise. In what appears to be a sound decision, judgment was rendered in favor

67. (S. Ct. 1905) 49 Misc. 8, 97 N. Y. S. 781.

68. (C. C. W. D. Pa. 1892) 51 Fed. 33, aff'd (C. C. A. 3, 1893) 57 Fed. 86.

of the defendant.⁶⁹ At the time the challenged transaction occurred, the plate glass industry was in its infancy, the demand exceeded the available supply, and despite the fact that plaintiff's capacity was over-taxed, the management was reluctant to expand. Here, then, the competition was only potential. Then, too, defendant was heavily interested in the plaintiff and became associated with the other enterprise for the chief purpose of protecting his investment in the plaintiff company. Much can be said for the common-sense of a holding that in these circumstances the defendant had not violated his fiduciary obligation by becoming associated with the new enterprise.

The foregoing cases are frequently regarded as sustaining the proposition that a corporate director is not, by reason of that status alone, precluded from entering into or becoming associated with a competitive business or company.⁷⁰ This proposition is obviously much broader than the cases upon which it purports to be based, as the latter involve at most only instances of *potential* competition.

While there are no cases squarely in point, nevertheless there are strong indications that some limitations exist on the director's privilege of becoming associated with a competitive enterprise.⁷¹ The X Company, a relatively small company, may, for example, have substantially all of the business of a particular type in a given community. If D, one of its directors, should launch a competitive business which cut into and substantially injured the business of X, he would have taken affirmative steps of a kind naturally calculated to injure his company.⁷² One to whom the task has been entrusted of furthering the best inter-

69. There was a further aspect to this case. Pitcairn later proposed the construction of a second plant, which was to be located outside of the territory within which plaintiff company was authorized to operate. It was held that Pitcairn violated no duty to the company by engaging in this activity.

70. See: 3 Cook, *Corporations* (8th ed. 1923) 2520, sec. 660, n. 3; 3 Fletcher, *Corporations* (Perm. ed. 1931) 168, sec. 856. See also: Carper v. Frost Oil Co. (1922) 72 Colo. 345, 349, 211 Pac. 370; Young v. Columbia Oil Co. (1931) 110 W. Va. 364, 371, 158 S. E. 678.

71. The connection with a competitive company would not involve a violation of the directoral duty where it had shareholder or company consent. *Steinway v. Steinway* (1896) 2 App. Div. 301, 37 N. Y. S. 742; *Baker v. Seattle-Tacoma Power Co.* (1911) 61 Wash. 578, 112 Pac. 647.

72. Cf. *Red Top Cab Co. v. Hanchett* (D. C. N. D. Cal. 1931) 48 F. (2d) 236. Apparently a director would not violate his fiduciary duty by engaging in a competitive business where his company had virtually suspended business and was hopelessly insolvent. See *Murray v. Vanderbilt* (N. Y. 1863) 39 Barb. 140 (president).

ests of an enterprise should hardly be permitted to engage in such conduct. Considerations similar to those which prevent a director from profiting from acquiring property capable of being used to the detriment of his company,⁷³ would seem to apply with equal force to this situation.⁷⁴

A somewhat different situation arises where a director of one company becomes affiliated with an already organized competitive company in a managerial or directoral capacity. A wisely considered judicial policy would, it is believed, dictate the view that he violates his fiduciary obligation to the first company by such conduct. The common director in such a situation is put in the impossible position of being duty-bound to serve impartially two masters with diametrically opposed interests.⁷⁵ Competitive companies constantly attempt to out-manoeuvre each other and the danger of a disclosure of plans and policies is great where the same person has an important managerial connection with both companies. Favoritism is a natural characteristic of human nature, and no matter how strong the resolution to act with strict impartiality may be, the individual placed in such a situation is likely to favor one company over the other. The consequences of such favoritism—whether inadvertent or planned—may well be far-reaching and disastrous. The degree of risk created by the common director frequently would turn, of course, on the relative financial stake, if any, which he had in the competitive companies. If his personal financial interest in the first company should be slight and that in the second should be heavy, the danger of the latter's being favored would, of course, be considerable. If, however, his financial interests in the companies should be reversed and his stake in the first company were heavy

73 See *supra*, page 190 et seq.

74. A considerable amount of *dictum* supports this conclusion. See: *Red Top Cab Co. v. Hanchett* (D. C. N. D. Cal. 1931) 48 F. (2d) 236, 238; *Coleman v. Hanger* (1925) 210 Ky. 309, 275 S. W. 784, 789; *Pioneer Oil & Gas Co. v. Anderson* (1933) 168 Miss. 336, 151 So. 161, 163; *Greer v. Stannard* (1929) 85 Mont. 78, 277 Pac. 622, 626; *Goldenrod Mining Co. v. Burvich* (1939) 108 Mont. 569, 92 P. (2d) 316, 320; *Hussong Dyeing Machine Co. v. Morris* (1913) 81 N. J. Eq. 256, 89 Atl. 249, 250. See also 2 Thompson, *Corporations* (3d ed. 1927) 773, sec. 1315.

75. Presumably the second company would have no grounds for complaint where the common director was re-elected with full knowledge of his prior affiliation. Note that in *Anderson v. Dunnegan* (1933) 217 Iowa 1210, 250 N. W. 115, it was held that one who was in active charge of corporate affairs might validly reserve a personal right to engage in transactions which his company would normally be interested in.

and that in the second slight, the danger of favoritism to the latter would be reduced greatly, although, of course, there always would be the danger of inadvertent disclosure of plans and policies. In any event, it is difficult to see why the risks incident to the director's plural corporate connections should in these circumstances be imposed on the company of his first connection, at least without the consent of a majority of its owners.⁷⁶ The common managerial phenomenon, where it concerns corporations between whom a substantial degree of competition exists, should be judicially condemned.⁷⁷

* * *

A review of the cases dealing with the limitations imposed by the directorship status on the personal business activities of directors reveals astonishingly few decisions.⁷⁸ It is interesting to note, though, that a large proportion of the litigated cases are characterized by a variety of inept and unsatisfactory rules purporting to determine the limits within which such activities may be properly conducted. A consistent and logical application of these propositions often would have led to absurd and indefensible results. It would not have been unreasonable, therefore, to anticipate that the law on this subject would prove unsatisfactory and chaotic. And while it may be justifiably condemned to some extent in this respect the commendable practice of the courts to ignore rules which would have produced intrinsically

76. If the shareholders of that company should re-elect the director with knowledge of his connection with its competitor, presumably the affiliation with the competitor would not be held to constitute a violation of his fiduciary obligation thereafter.

77. In the absence of proof that the common director injured the company of his original connection by revealing confidential information, the latter's remedy for the director's breach of his fiduciary obligation presumably would be limited to a recovery of the compensation or profits accruing to him as the result of his connection with its competitor. It is recognized that the amount of such recovery frequently would supply little direct financial deterrent to such association as it often would be true that the director received only a nominal, if any, compensation for his services. Even though this be admitted, legal stigmatization of such conduct should have some effect. A comprehensively effective deterrent probably will have to await legislative action.

78. And the cases which have arisen involve for the most part comparatively small or "closed" corporations. It is interesting to speculate on why the large corporation does not appear more frequently in the picture. Professor Dodd suggests that effective supervision over the affairs of large corporations in the interests of shareholders is largely impracticable. *Dodd, Is Effective Enforcement of the Fiduciary Duties of Corporate Managers Practicable?* (1935) 2 U. of Chi. L. Rev. 194. Can this be the explanation?

unsound decisions has permitted the development of a framework of decisions which has considerable merit. This condition of the law can hardly be regarded as fortuitous. Rather it would seem that the current of judicial decision has been appreciably influenced by a basically consistent conception of the status of the director in the corporate picture. This conception of the director apparently begins and ends with the idea that his great duty and responsibility is to further the purposes of the enterprise which he represents. It has for the most part produced a sound body of law which refuses to countenance those personal business activities of directors which conflict with that objective.