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CORPORATIONS - COMMON BOARD - FRAUD - RATIFICATION BY MAJORITY STOCKHOLDERS

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CORPORATIONS — COMMON BOARD — FRAUD — RATIFICATION BY MAJORITY STOCKHOLDERS — Defendants were directors and officers of a managing corporation and its subsidiary. Both corporations paid defendants salaries, those from the managing corporation approximating the fees paid to it by the subsidiary for management services which were rendered by defendants. *Held*, payment of management fees by the subsidiary under such circumstances is fraudulent and recoverable from defendants, in a derivative suit by minority stockholders, despite a resolution of the majority stockholders of the subsidiary ratifying the payment. *Eshleman v. Keenan*, (Del. Ch. 1936) 187 A. 25.

It is generally accepted that the majority stockholders cannot, over the protests of the minority, ratify a fraud committed against the corporation.[1] The prevailing problem, then, is whether or not the acts, sought to be upheld by such ratification, constitute fraud. Interlocking directorates for different corporations are not fraudulent per se,[2] but action by such boards will not be permitted to accomplish a fraudulent end.[3] However, transactions between corporations conducted entirely through the agency of officers acting at the same time for both corporations are voidable.[4] But even though transactions of this character might be avoided by either of the corporations, it would seem that

[1] Rogers v. Hill, 289 U. S. 582, 53 S. Ct. 731 (1933); Dana v. Morgan, (D. C. N. Y. 1914) 219 F. 313; Brewer v. Boston Theatre, 104 Mass. 378 (1870). See also, 13 FLETCHER, CYCLOPEDIA CORPORATIONS, perm. ed., § 5795, p. 92 (1932), and 3 COOK, CORPORATIONS, 8th ed., § 662, p. 2534 (1923).

[2] International Stevedoring Co. v. Frank Waterhouse & Co., 129 Wash. 451, 225 P. 420 (1924); Bergenthal v. State Garage & Trucking Co., 179 Wis. 42, 190 N. W. 901 (1922); 3 FLETCHER, CYCLOPEDIA CORPORATIONS, perm. ed., § 961, p. 338 (1932).

[3] Equitable Trust Co. v. Denver & R. G. R. R., (D. C. Colo. 1920) 269 F. 987; Irving Bank-Columbia Trust Co. v. Stoddard, (C. C. A. 1st, 1923) 292 F. 815; Corsicana Nat. Bank v. Johnson, 251 U. S. 68, 40 S. Ct. 82 (1919).

[4] Mathieson Alkali Works v. Arnold, Hoffman & Co., (D. C. R. I. 1922) 280 F. 132; Bentley v. Zelma Oil Co., 76 Okla. 116, 184 P. 131 (1919); Geddes v. Anaconda Copper Min. Co., 254 U. S. 590, 41 S. Ct. 209 (1921). Contra: Pennsylvania R. R. v. Minis, 120 Md. 461, 87 A. 1062 (1913); Davis v. United States Elec. Power & Light Co., 77 Md. 35, 25 A. 982 (1893).

they could be ratified by a majority of the stockholders, and thus bind the corporation, unless there be a fraud on the minority stockholders.[5] The court in the principal case found that there was fraud present, in that the management services rendered to the subsidiary by the defendants were no more than the services they owed the subsidiary as its paid officers, and further that no impartial voice in the corporation had spoken in authorization of their double compensation, which was secured through dealing with themselves, the stockholders (i.e. the minority stockholders) being ignorant of the transaction.[6] It is to be regretted that the court found the case for relief so plain that it thought the citation of authorities needless,[7] for the cases are generally confused as to those transactions which are to be threshed out within the corporation and those in regard to which the courts will act to protect the interests of the minority stockholders.[8] Ordinarily the officers' compensation is within the control of the directors; [9] likewise, as seen above, ordinarily contracts between corporations with common officers and directors are valid[10] and subject to ratification by the majority stockholders if available.[11] However, it has been held that stockholders who are also directors may not act to the injury of the minority stockholders; [12] nor may directors who are also majority stockholders use corporate funds for their own enrichment over the protests of the minority.[13] Further, ratification can never be made on the part of the corporation by the same persons who assumed the power to make the contract; that is, the corporate officers cannot ratify their own wrongful acts.[14] Or, if the effect of ratification is to give away corporate property, it may be successfully attacked by a minority stockholder,[15] though it has been pointed out that this reasoning could be used to justify the courts in scrutinizing every corporate transaction challenged by a minority stockholder.[16] It is apparent that the court in the principal case reached a just and sound result, yet a more direct attack upon the problem of why the transaction involved such fraud as could not be ratified would have been appropriate to the decision.

Theodore R. Vogt

[5] Caldwell v. Dean, (C. C. A. 5th, 1925) 10 F. (2d) 299; Michigan Slate Co. v. Iron Range & H. B. R. R., 101 Mich. 14, 59 N. W. 646 (1893); General Inv. Co. v. American Hide & Leather Co., 97 N. J. Eq. 230, 127 A. 659 (1925). See also, 3 FLETCHER, CYCLOPEDIA CORPORATIONS, perm. ed., § 979, p. 363 (1932).

[6] Eshleman v. Keenan, (Del. Ch. 1936) 187 A. 25.

[7] Eshleman v. Keenan, (Del. Ch. 1936) 187 A. 25.

[8] See comment, 32 MICH. L. REV. 839 (1934).

[9] Godley v. Crandall & Godley Co., 212 N. Y. 121, 105 N. E. 818, L. R. A. 1915D 632 (1914); Fillebrown v. Hayward, 190 Mass. 472, 77 N. E. 45 (1906); Jones v. Morrison, 31 Minn. 140, 16 N. W. 854 (1883). See, however, Rogers v. Hill, 289 U. S. 582, 53 S. Ct. 731 (1933), and 32 MICH. L. REV. 839 (1934).

[10] See note 2, supra.

[11] See note 5, supra.

[12] Townsend v. Winburn, 107 Misc. 443, 177 N. Y. S. 757 (1919).

[13] Joyce v. Congdon, 114 Wash. 239, 195 P. 29 (1921).

[14] McCray v. Sapulpa Petroleum Co., 102 Okla. 108, 226 P. 875 (1924); Oliver v. Rahway Ice Co., 64 N. J. Eq. 596, 54 A. 460 (1903); 3 THOMPSON, CORPORATIONS, 3d ed., § 2107, p. 744 (1927).

[15] Rogers v. Hill, 289 U. S. 582, 53 S. Ct. 731 (1933).

[16] 32 MICH. L. REV. 839 at 851 (1934).