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Harold R. Smith
University of Michigan Law School

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PURCHASE OF SHARES OF A CORPORATION BY A DIRECTOR FROM A SHAREHOLDER.

AS SUGGESTED by the title to this paper, a discussion of the relationship between the directors of a corporation and the corporate entity is not within its scope. Neither is the relationship between the directors and the entire body of the shareholders. These two subjects are generally treated in another branch of the law of corporations and generally are not governed by the same rules of law.[1] The purchase of shares of stock by a director from a non-official shareholder naturally brings into question the relationship between the director and the shareholder in his individual capacity, and not in his capacity as the representative of the corporation or the entire body of the shareholders.[2]

This same subject was the title of a paper which was published in the MICHIGAN LAW REVIEW for 1910.[3] In that article, all the decisions upon the subject were reviewed and conclusions drawn from them by the author. In 1910, the weight of judicial decision had undoubtedly established the rule that a director in purchasing the shares of stock of a non-official shareholder was bound by no duty to the shareholder to disclose any facts relative to the condition or future prospects of the corporation, even though those facts might have had an important bearing on the then present value of the stock. And if the sale was conducted without actual fraud on the part of the director, that is, without misrepresentation or active concealment, the sale could not be set aside, nor could the director be held to account to the shareholder for the profits resulting from a rise in the value of the stock immediately subsequent to the sale.[4]

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[1] Walsh v. Goulden, 130 Mich. 531, 539: "Directors, of course, stand in a fiduciary relation to the corporation itself. They do not stand in that relation, however, when dealing with other stockholders for the purchase or sale of stock." Cf. Crowell v. Jackson, 53 N. J. L. 656, 657.

[2] Dodge v. Woolsey, 18 How. 331, where a shareholder was allowed to maintain an action against the directors as representative of the entire body of the shareholders and the corporation.

[3] 8 MICH. LAW REV. 267.

[4] Grant v. Attrill, 11 Fed. 469; Gillett v. Bowen, 23 Fed. 625; Hooker v. Midland Steel and Iron Company, 215 Ill. 444; Board of Commissioners of Tippecanoe County v. Reynolds, 44 Ind. 509; In re Shreveport Bank, 118 La. 664; Walsh v. Goldden, 130 Mich. 531; Crowell v. Jackson, 53 N. J. L. 656;

There are frequent expressions in the older decisions such as, "a director * * * may deal with an individual shareholder and purchase his stock practically on the same terms as a stranger,"[5] and, "the directors are not the bailees, the factors, agents, or trustees of such individual stockholders."[6]

The almost universal adoption of this rule so broad in terms, has brought down a storm of protest from the writers in the periodicals, who proclaim it to be contrary to the dictates of ethics and sound morals.[7] It has been urged by others that to continue the rule would be contrary to sound business policy.[8] And it would seem to be perfectly obvious that if the directors were allowed to manipulate the affairs of their corporation in such a manner as to discourage the small investor and then purchase his shares at a nominal price,—that, if they are allowed to make such purchases with impunity and without fear of avoidance of the sale, then the small investor will ultimately be forbidden to invest in the stock of corporations. The ultimate success of the corporate form of business enterprise lies in making the corporation a reasonably safe place for investment,—at least secure from the passive frauds of its officers and directors. This necessarily involves the abrogation of the old rule,—if not *in toto,* at least in some of the more extreme cases.

Such an extreme case presented itself to the Supreme Court of the United States in 1909. *Strong* v. *Repide*[9] was correctly predicted by the author of the former article in the MICHIGAN LAW REVIEW to be a leading case upon the relation of director to non-official shareholder in the purchase of the latter's shares of stock. The court in that case admitted the existence of the general rule that the director in purchasing the shares of a shareholder owes to him no duty to disclose the condition of the corporate affairs. However, Justice Peckham, in speaking for the court, announced for the first

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Carpenter v. Danforth, 52 Barb. 581; Stark v. Soule, 27 N. Y. Week. Dig. 80; Krumbhaar v. Griffeths, 151 Penn. St. 223; Deaderick v. Wilson, 8 Baxt. (Tenn.) 108; Haarstick v. Fox, 9 Utah 110; O'Neile v. Ternes, 32 Wash. 528; Percival v. Wright, [1902] 2 Ch. 421.

[5] Hooker v. Midland Steel and Iron Company, 215 Ill. 444.

[6] Smith v. Hurd, 12 Met. 371,—per Chief Justice Shaw.

[7] 67 CENTRAL L. JOURNAL, 452.

[8] 81 CENTRAL L. JOURNAL, 256.

[9] Strong v. Repide, 213 U. S. 419. For a full discussion of the facts and holding in this case, see 8 MICH. L. REV. 268.

time the so-called *special facts* doctrine, that where there are special facts connected with the sale of the stock, the case may be taken out of the general rule and a duty devolve upon the director to make a full and accurate disclosure to the shareholder of all facts within his knowledge which have a bearing upon the real value of the stock. It may be well, in this connection, to enumerate the special facts which took *Strong* v. *Repide* out of the general rule and rendered the purchasing director liable to the shareholder for the profit resulting from the transaction: (1) The director owned a majority of the stock of the corporation, (2) He was the chief negotiator in the sale of the company's lands to the government, which sale was the sole cause of the difference between the real and the apparent value of the stock of the corporation at the time of the transaction, (3) The negotiations were for the sale of the entire property of the corporation, (4) Through the acquiescence of the shareholders, he was acting substantially as their agent in the sale of their stock, (5) He concealed his identity as purchaser from the shareholder, (6) The nature of the corporation itself, as pointed out in a recent case,[10] was also an important circumstance which contributed to the result reached in *Strong* v. *Repide*. The land which was owned by the corporation was its only asset, and this was held for the sole purpose of a favorable opportunity to sell to the government. "Corporation" was merely a name which had been conferred upon an inactive partnership.

A recent article in the YALE LAW JOURNAL suggested to the writer the possible utility in bringing down to date the original article in the MICHIGAN LAW REVIEW on this subject and reviewing the decisions that have been handed down in the last decade.[11] A majority of these thirteen cases have seized upon the *special facts* doctrine advanced by the Supreme Court of the United States as a means of escape from the rigour of the general rule adhered to by the older decisions. Fletcher, in his recent work on corporations, seems to have been the first author to have recognized that there existed such an exception to the general rule.[12] This, however, is not at all due

[10] Haverland v. Lane, 89 Wash. 557, 568.

[11] "To make such an analysis, *except as to cases decided since* 1910, would indeed be a work of supererogation in view of Professor Wilgus' article." Professor Clarence D. Laylin, 27 YALE L. JOUR. 731.

[12] 4 FLETCHER, CYCLOPEDIA OF CORPORATIONS, (1920) § § 2566, 2567.

to the oversight of the older authorities, for his is the only exhaustive work on the subject of corporations which has been published since the decision in *Strong* v. *Repide*.

It may be well to take up the cases in their chronological order, for this method will better show the course of development of the law.

In February, 1911, the Court of Appeals of the District of Columbia handed down the decision in *George* v. *Ford*.[13] Ford was a manager and the director of the Beaty Lumber Company and held five-sixths of the corporate stock. George held the other one-sixth part of the stock. Ford represented to George that the affairs of the company were in such a deplorable condition that it would be necessary for the company to sell out to its competitor in order to prevent dissolution. George then gave Ford a power of attorney to sell his stock in the Beaty Lumber Company. Ford was a large shareholder in the competitor at the time of this transaction. He purchased the George stock under the power of attorney and then exchanged this together with all of his original holdings in the Beaty Lumber Company for an equal number of shares in the competitor. These shares Ford continued to hold in his own name. George later discovered that he had parted with his stock in the Beaty Lumber Company at a mere fraction of its real value.

The case came up on the defendant's demurrer to the plaintiff's bill for an accounting. The principal ground of demurrer was that the facts alleged in the complaint did not state a cause for relief. In overruling the demurrer, the court said: "That the defendant was manager of the Beaty Lumber Company and the plaintiff a director and shareholder thereof did not necessarily constitute such a fiduciary relation between them as would render the transaction of December 21, 1899, voidable for that reason alone. * * * But the facts alleged, substantially, that the plaintiff, though a director, took no active part in the management, and relied, as the defendant knew, on him as manager and friend and fellow shareholder to keep him informed of all matters relating to the operations and financial condition of the corporation. That under these circumstances, he sought the plaintiff apparently to induce him to constitute the defendant his agent to sell and pass title to his stock and interests, would seem to have imposed not only a moral but an equitable obligation upon him,

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[13] George v. Ford, 36 App. Dist. Col. 315.

when dealing with the plaintiff, to disclose to him the material facts of the situation."[14]

Here, as in *Strong* v. *Repide,* Ford, as director, owned a majority of the stock; he was the chief negotiator in the sale of the company's assets; the sale was for the entire property of the corporation; and he was acting as agent for the plaintiff in the sale of his stock. In addition, the plaintiff and the defendant were the only shareholders in the corporation. These are in brief the special facts upon which the court rested its decision.

Now it is true that in the case of *George* v. *Ford* there was an actual misrepresentation by the defendant, Ford, and this was relied on by the court in rendering its opinion. However, in another part of the opinion, the decision is rested upon the special facts enumerated above as creating a fiduciary relation between director and shareholder, and this must at least be taken to have been a *ratio decidendi.*

Bawden v. *Taylor*[15] was decided by the Supreme Court of Illinois in June, 1912. Taylor was the president and general manager of the Taylor Publishing Company, publishers of a scientific bulletin called the *Eagle*. Taylor entered into negotiations with a publishing house in New York City for the sale of the *Eagle*. Bawden, who was a non-official shareholder in the Taylor Publishing Company, knew of the pending negotiations, but was entirely dependent upon Taylor for information in regard to the price to be paid for the *Eagle*. Taylor bought Bawden's stock at a price that was somewhat below its actual value, without disclosing the price to be paid by the New York firm for the *Eagle*. The court refused to grant a rescission of the sale, holding that the case fell within the general rule, that there is no duty on the part of a director to disclose circumstances within his knowledge affecting the value of the stock when buying the stock of a non-official shareholder. In this, they merely followed the earlier Illinois decision in *Hooker* v. *Midland Steel and Iron Company.*[16]

In *Bacon* v. *Soule,*[17] July, 1912, the California Court of Appeals reached a like result. The plaintiff, Bacon, and his two sisters, defendants, were the only shareholders in the Bacon Land Company,

[14] George v. Ford, 36 App. Dist. Col. 315, 328.

[15] Bawden v. Taylor, 254 Ill. 464.

[16] Hooker v. Midland Steel and Iron Company, 215 Ill. 444. Cf. 8 MICH. L. REV. 286.

[17] Bacon v. Soule, 19 Cal. App. 428.

a corporation engaged in the real estate business. The two defendants were directors. For many years the plaintiff had taken little or no interest in the affairs of the company. The shareholders decided to dissolve the corporation and turn in their stock in exchange for allotments in the land held by the company. The defendants demurred to the plaintiff's complaint for fraud and deceit, which alleged that a certain house had been alloted to him under this agreement, that the value of the house had decreased greatly on account of the removal of fixtures before the time of the agreement to dissolve, that he had no knowledge of the removal of the fixtures, but believed that the house was in the same condition as it was when he was actively engaged in the business of the corporation, and that, although the defendants knew that he was acting under this belief, they had failed to make any disclosure to him. The demurrer to the complaint was sustained and the court reiterated the old rule that there is no duty on the part of a director to disclose facts relative to the management when dealing with a shareholder. However, if there are any *special facts* in *Bacon* v. *Soule,* they would seem to argue in favor of imposing no duty upon the director to disclose rather in support of the principle recognized in *Strong* v. *Repide.* "In the case at bar," the court remarks, "it is apparent that in dealing with the subject-matter of the controversy the defendants were not acting in any manner as the representatives of the corporation. On the contrary, they, as individuals, were dealing with the plaintiff as an individual in a transaction purely personal to each of them, and therefore, their respective duties and obligations to one another must be measured by the ordinary rules regarding transactions between individuals rather than by those which pertain to and govern the conduct of officers of a corporation in the management and control of the corporation's affairs and property."[18]

In *Gadsden* v. *Bennetto,*[19] March, 1913, Gadsden was the owner of two shares of stock in the Kooteney Valley Fruit Lands Company, a corporation organized for the sole purpose of holding a tract of fruit lands with the view to a future advantageous sale. The two defendants were directors and officers of the company. Bennetto, one of the defendants, entered into negotiations for the sale of the company's holdings and secured an offer of $80,000. The

[18] Bacon v. Soule, 19 Cal. App. 428, 438.

[19] Gadsden v. Bennetto, 23 Manitoba L. Rep. 33, 9 Dom. L. Rep. 719, *reversing,* 21 West. L. Rep. 886, 5 Dom. L. Rep. 529.

defendants, as directors, knowing of the offer, passed a resolution appointing themselves a committee to bring in proposals for the sale of the company's property. They then bought in Gadsden's stock at $1,370 per share without disclosing to him the $80,000 offer. The committee then brought in a proposal to accept the offer, the lands were sold, and the price received raised the share value of the stock to $2,000. The proceeding was in the nature of a bill in equity to have the defendants declared trustees of the profits realized on Gadsden's stock.

In granting relief, Perdue, J. A., at pages 39 and 40 of the Manitoba Report distinguishes the case from the earlier English decision, which declared that there was no fiduciary relation between director and shareholder:

> "The position of the members of the committee is very different from ordinary directors of a company as regards their fiduciary relations, and is quite distinguishable from *Percival* v. *Wright*, [1902] 2 Ch. 421. In the present case the committee were acting outside the ordinary duties of directors, they were appointed for the purpose of securing and bringing in a proposal for disposing, not only of the land which was the property of the Company, but the shares which were the property of the individual shareholders. On any proposal being received by them which involved the acquisition of the shares, they were bound to disclose to the shareholders, the interested parties, the nature of the proposal and the price offered. If the proposal took the form of acquiring all the Company's property and leaving the shares out of account, the shareholders would be immediately interested in that proposal because their shares would become worthless when the property was transferred and they could only look for reimbursement to their share of the purchase money on a distribution being made. If the committee, acting under its duties to the Company and the shareholders secured a highly advantageous offer, they were bound to make a full disclosure of the offer to the Company and the shareholders. The members of the committee were the confidential agents of the Company and the shareholders. Their concealment of Cooper's offer, which so greatly enhanced the value of the shares, with a scheme in view to buy the shares at a low price, was

a breach of duty and a fraud upon the shareholders whose shares they acquired by means of that concealment, at a price far less than their intrinsic value.

"The learned trial judge dealt with the case as if Bennetto and Wellband were mere directors of the Company and gave his decision upon the view that, as directors, no duty was cast upon them to make to the individual shareholders full disclosure of the negotiations that were pending with Cooper.

"Without expressing any opinion on the duty of directors to the individual shareholders in such a case, I think the learned trial Judge quite overlooked the fact that the three members of the committee were, by reason of the resolution appointing them, and by their acceptance of the duty imposed by it upon them, acting outside the scope of ordinary directors, and that a fiduciary relationship had been established between them, on the one hand, and the Company and the individual shareholders on the other."

In *Black* v. *Simpson*,[20] April, 1913, the defendant, Simpson, was a director and the general manager of the Farmers' Fertilizer Company, in which the plaintiffs were shareholders. Simpson conceived and entered upon a scheme of acquiring the entire stock of the Company at much less than its actual value by representing to each of the plaintiffs that the corporation was not prosperous. He successfully carried out this plan, and thereby induced the plaintiffs and other shareholders to sell to him their holdings in the corporation at a price greatly under the real value. He then made a considerable profit on the transactions by the sale of the entire corporate assets. The South Carolina court compelled Simpson to account for the profits to the shareholders from whom he had purchased.

It is true that in *Black* v. *Simpson* there were actual misrepresentations made by the director for the purpose of inducing the shareholders to sell their stock. But inasmuch as the court elected to rest their decision not upon the ground of actual fraud, but rather upon the breach of the fiduciary or quasi-trust relation between the director and the individual shareholders, the latter ground must be taken to be the real basis for the decision. It will be noticed that in *Black* v. *Simpson* there was a general scheme to induce the sale of the shares at less than their real value; and, during the course of the

[20] Black v. Simpson, 94 S. C. 312.

opinion, Justice Woods singles out this fact as a reason for the existence of the quasi-trust relation between the director and shareholder.

The *special facts* doctrine was again advanced in the case of *Allen* v. *Hyatt*.[20a] Here again, as in *Gadsden* v. *Bennetto*,[21] the court distinguished the earlier decision in *Percival* v. *Wright*.[21a] The plaintiffs were non-official shareholders in the Lakeside Canning Company, Ltd. The defendants were directors and held $10,000 out of the capital stock of $30,500. During the time that negotiations were pending for the sale of the entire corporate property to the Dominion Canners, Ltd., in furtherance of a proposed amalgamation of all the canning companies in Canada, the directors approached the plaintiffs and secured options on their stock at $250 a share without disclosing to them the price to be paid by the Dominion Company. The options were exercised and the sale of the corporate property of the Lakeside company was completed with a handsome profit resulting to the defendants on the plaintiffs' shares of stock. The Supreme Court of Canada held that the directors should hold the profits as trustees for the shareholders. Speaking for the Court, Haldane, L. C., said:

> "The appellants appear to have been under the impression that the directors of a company are entitled under all circumstances to act as though they owed no duty to individual shareholders. No doubt the duty of the directors is primarily one to the company itself. It may be that in circumstances such as those of *Percival* v. *Wright* [1902] 2 Ch. 421, which was relied on in the argument, they can deal at arm's length with a shareholder. But the facts, as found in the present case, are widely different from those in *Percival* v. *Wright*, and their Lordships think that the directors must be taken to have held themselves out to the individual shareholders as acting for them on the same footing as they were acting for the company itself, that is *as agents*."[22]

The case of *Steinfield* v. *Nielsen*,[23] commented on in the previous

[20a] Allen v. Hyatt, 30 Times L. Rep. 444, *affirming*, 17 Dom. L. Rep. 7. *affirming* 8 Dom. L. Rep. 79, *which affirmed*, 20 Ont. W. Rep. 594, 3 Ont. W. N. 370, *which affirmed*, 10 Ont. W. Rep. 850, 2 Ont. W. N. 927.

[21] Gadsden v. Bennetto, *supra*, note 19.

[21a] Percival v. Wright, [1902] 2 Ch. 421. Cf. 8 MICH. L. REV. 281.

[22] Allen v. Hyatt, 17 D. L. R. 7, 11.

[23] Steinfeld v. Nielsen, 12 Ariz. 381.

article in the MICHIGAN LAW REVIEW,[24] was subsequently carried to the Supreme Court of the United States on appeal,—Arizona at that time being a territory. The Supreme Court refused to consider the case on its merits because the court of the territory had failed to find the facts in the nature of a special verdict, as required by law. The case was therefore reversed, the reversal to "have the legal effect of causing the case to be as though it were yet pending undetermined on the appeal from the trial court."[25] The case of *Steinfeld* v. *Nielsen* in 12 Arizona, therefore, must be considered as a mere nullity so far as its authoritative value is concerned.

The case again came before the Supreme Court of Arizona and was finally decided by that court in April, 1914,—Arizona then having been admitted as a state.[26] To review the facts of the case briefly, Steinfeld, though not a director, was the owner of the majority of the stock, and, in the words of the court, "Steinfeld's domination of the company was absolute." Nielsen was a director and the superintendent of the company's mine. Steinfeld conceived the idea of purchasing adjacent mines with the object of thus increasing the value of the entire group of mines in order that the entire group might be sold at a more favorable price. With this in view, and also for the purpose of acquiring the Nielsen stock at a nominal price, he caused the mine to be shut down and discharged Nielsen from the board of directors and his position as superintendent of the mine. The adjacent mines were bought in at a low figure and so was Nielsen's stock. The whole property was then sold at such a price that, in consideration of the probability of such a sale, Nielsen's stock was actually worth twice e price that Steinfeld had paid for it.

Justice Ross, in rendering the opinion of the court, first stated the general rule as to the relation between director and shareholder. He then averted to the case of *Strong* v. *Repide* and set out at length the doctrine of *special facts* in that case. "We would be bound by that case," reads the opinion, "if the facts in this case were the same. In that case Strong was not an officer of the company and had no part in its management, and the sale to the government was entirely in Repide's charge and pending at the time he bought the Strong shares.

[24] 8 MICH. L. REV. 290.

[25] Steinfeld v. Nielsen, 224 U. S. 534, 540, 32 Sup. Ct. Rep. 609, 612, 56 L. Ed. 872.

[26] Steinfeld v. Nielsen, 15 Ariz. 424, 139 Pac. 879.

Nielsen was not only a stockholder in the Nielsen Mining & Smelting Company, but was also a director. He was also superintendent of the mines and smelter. * * * Under these circumstances, there were no *special facts* known to Steinfeld that were not also known to Nielsen."[27]

There were no *special facts* in the case of *Shaw* v. *Cole Manufacturing Company*,[28] April, 1915, and consequently the case followed the general rule that the director is not liable to the shareholder for failure to disclose facts relative to the condition of the company when purchasing his stock. In this case, the Coles purchased from the Shaws at a price greatly under the real value, without informing the Shaws of facts relative to the condition of the company, which facts did not appear in the company's books. In arriving at their decision, the court followed the former Tennessee case of *Deaderick* v. *Wilson*.[29] However, they felt constrained to refer to the decision of *Strong* v. *Repide* and pointed out two *special facts* in that case which were not present in the case at bar, namely, the extensive information of the managing director, and the director's concealment of the fact that he was the real purchaser of the stock.[30]

Haverland v. *Lane*,[31] decided by the Supreme Court of Washington in February, 1916, also held according to the general rule. The plaintiff was a shareholder in the Consolidated Telephone Company, and the defendant was a director of that company. The company was in hard circumstances and no dividends had been declared for a number of years. The defendant negotiated a loan by the terms of which he was to transfer to the Securities Company a number of the shares of the Consolidated Telephone Company as security. Without telling the plaintiff of the loan, he bought the plaintiff's shares and transferred them to the Security Company. Subsequently there was a rise in the value of the stock of the Consolidated Company.

In distinguishing the case from *Strong* v. *Repide*, the court said:

> "In that case there was an inactive corporation. It was no

[27] Steinfeld v. Nielsen, 15 Ariz. 424, 445, 446.

[28] Shaw v. Cole Manufacturing Company, 132 Tenn. 210.

[29] Deaderick v. Wilson, 8 Baxt. (Tenn.) 108. See note 4, *supra*. Cf. also, 8 MICH. L. REV. 276.

[30] Shaw v. Cole Manufacturing Company, 132 Tenn. 210, 214.

[31] Haverland v. Lane, 89 Wash. 557, 154 Pac. 1118.

more than a name. * * * The principal owner because of his large controlling interest had been consulted and knew that the lands might be sold for a price to be agreed upon; that a large sum of money had been offered by the government. He did not go to the complaining stockholder or to her agent, although he knew him. * * * Every effort was made to conceal the prospective sale of the lands, and the immediate purchaser of the stock."[32]

In the case at bar the court pointed out that there were no *special facts*. There was no effort on the part of the director to conceal his identity, nor was there anything unusual about the nature of the corporation itself. Hence, the general rule as announced in the earlier Washington case of *O'Neile* v. *Ternes*[33] was followed and the director was sustained in his defense to an action for deceit by the shareholder.

In *Jacquith* v. *Mason*,[34] March, 1914, the plaintiff owned 201 shares of stock in the Underwriters Insurance Company. No dividends had been declared on this stock for several years. The president of the company bought in the plaintiff's stock at $75 per share without informing her that negotiations for the sale of all the company's assets had practically been closed. The final consummation of the deal caused the stock of the Underwriters Company to jump to $110 per share.

The court did not attempt to find any *special facts* in their opinion, but held that the defendant's liability rested upon the rule that in all cases regardless of the circumstances there is a relation of trust between director and individual shareholder as to the latter's shares of stock, and that the director, in purchasing the shares of a non-official shareholder, owes a duty to disclose. This view was first advanced in *Oliver* v. *Oliver*[35] and followed in *Stewart* v. *Harris*.[36]

The same rule was again followed in the recent Iowa case of *Dawson* v. *National Life Insurance Company*,[37] which was decided

[32] Haverland v. Lane, 89 Wash. 557, 568.

[33] O'Neile v. Ternes, 32 Wash. 528. See note 4, *supra*. Cf. also 8 MICH. L. REV. 283.

[34] Jacquith v. Mason, 99 Neb. 509.

[35] Oliver v. Oliver, 118 Ga. 362. Cf. 8 MICH. L. REV. 286.

[36] Stewart v. Harris, 69 Kan. 498. Cf. 8 MICH. L. REV. 286.

[37] Dawson v. National Life Insurance Company, 176 Iowa 362.

in May, 1916. The defendants were directors and officers of the Des Moines Insurance Company. The plaintiff, Dawson, held three shares of the company's stock. An agreement was concluded between the defendants and the National Life Insurance Company by which the latter was to purchase all the stock of the Des Moines Insurance Company. According to the terms of the agreement, Harbach, one of the defendants, who was also an officer of the National Company, was to purchase the stock of all the small shareholders of the Des Moines Insurance Company for the purpose of later transferring them to the National Insurance Company. Harbach bought the plaintiff's stock at $200 per share without disclosing to him the existence of the contract with the National Company or any of its terms. The average price which the defendant's received for their own shares when they were transferred to the National Insurance Company was about $1,000.

Here too the court laid down in bold terms the doctrine that the fiduciary relation between director and shareholder does not rest on any *special facts,* nor did the court search for any. Justice Ladd commented on the decision in *Strong* v. *Repide* in the following manner:

> "That the writer of the opinion in Strong's case was mistaken in saying that the decisions were based on special facts which took them out of the general rule clearly appears from our quotation from the Georgia case[38] and the language of the instruction in the Kansas case."[39]

The facts, as set out in the opinion in *Poole* v. *Camden,*[40] decided in November, 1916, are rather meager. However, it is clear that the plaintiff was a non-official shareholder and the defendant, Camden, was a director in the Interurban Railway Company. The plaintiff called on Camden and asked to be advised as to the value of her stock and the condition of the corporation, but Camden told her nothing. Camden then bought the plaintiff's stock at less than its real value. The lower court decreed that the sale be set aside and the defendant account to the plaintiff for such dividends as he had received on the stock subsequent to its sale by the plaintiff, and this decree was affirmed in the supreme court.

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[38] Oliver v. Oliver, 118 Ga. 362.

[39] Stewart v. Harris, 69 Kan. 498.

[40] Poole v. Camden, 79 W. V. 310.

The basis for the decision is to be found on page 319 of the report, where Judge Lynch says:

> "Conceding the so-called majority rule to be the correct one, we think, upon the principles of the cases just referred to, recognizing the exceptions, that where a stockholder, who, as in this case, is first sought by a secret agent of a director, with a proposition to buy his stock, and the stockholder goes to such director to obtain full information respecting the value of his stock and the condition of the corporation, its plans and prospects, the reason for a recent reduction of dividends, and all other information affecting or tending to affect the value of the stock, such director cannot *withhold any information within his knowledge,* or in any way mislead or deceive him, or by acts, words, or conduct, induce a sale of the stock to him, except upon penalty of having the sale rescinded at the option of the stockholder; that if he undertakes to speak or become active in inducing the sale he must speak fully, frankly, and honestly, and conceal nothing to the disadvantage of the selling stockholder."

The case which most clearly marks out the development of the *special facts* doctrine is *Bollstrom* v. *Duplex Power Car Company,*[41] decided by the Supreme Court of Michigan in December, 1919. Bollstrom owned 1,161 shares of stock in the Duplex Power Car Company in which both Murray and Town were directors and Town was also the majority stockholder. Ever since the organization of the company in 1909 it had been in deplorable financial condition. No dividends had been declared, and assessments had been levied against the stock to meet the claims of creditors. At times the stock, which had a par value of ten dollars, was not actually worth ten cents on the dollar. In 1916, Town entered into an agreement with Lansing capitalists under which they were to buy three-fourths of the stock of the Duplex Power Car Company and transfer the stock to a syndicate which they agreed to incorporate. The syndicate was to pay twenty dollars a share for the stock received from the Duplex Company. With full knowledge of this agreement and in furtherance thereof, Murray purchased the plaintiff's shares at the par value of ten dollars. Bollstrom had no knowledge of the agreement and

[41] Bollstrom v. Duplex Power Car Company, 208 Mich. 15, 175 N. W. 492.

had been inactive in the affairs of the Duplex Power Car Company for some time. It was held that Bollstrom was entitled in equity to the difference between the sale price and the real value of the shares at the time of the sale.

Justice Sharpe, in his opinion, proceeds to distinguish the former Michigan case, *Walsh* v. *Goulden*,[42] which had held that there was no duty on the part of the purchasing director to disclose facts relative to the condition of the corporation to the shareholder. Referring to that decision, he says:

> "As applied to a *going* concern, whose records reveal the value of the stock, and the good will and intangible assets of which are presumably as well known to one shareholder as to another, there may be no hardship in so holding. But the proofs in this case present a different situation."

And again:

> "We think the facts in this case bring it squarely within the rule laid down in *Strong* v. *Repide*. In that case, the president of a corporation purchased stock at much less than its par (real?) value, as known to him, and, due to conditions, unknown to the stockholders."

By merely counting noses, it will be found that since 1910 eight cases[43] have imposed a liability in one form or another upon the director for failure to disclose, while there are but five cases[44] which take the view that there is no liability. This would seem to disclose a marked departure from the settled law before that time. However, mere numerical weight is a rather unsatisfactory and superficial method of arriving at the true state of the law.

Of the five cases deciding that there is no liability, three followed the general rule laid down in former cases in the same state, but

[42] Walsh v. Goulden, 130 Mich. 531, 90 N. W. 406. Cf. note 4, *supra*, and also 8 MICH. L. REV. 282.

[43] George v. Ford, 36 App. Dist. Col. 315; Black v. Simpson, 94 S. C. 312; Allen v. Hyatt. 17 D. L. R. 7; Jacquith v. Mason, 99 Neb. 509; Dawson v. National Life Insurance Company, 176 Iowa 362; Poole v. Camden, 79 W. V. 310; Bollstrom v. Duplex Power Car Companv. 208 Mich. 15, 175 N. W. 492; Gadsden v. Bennetto, 23 Manitoba L. Rep. 33, 9 D. L. R. 719.

[44] Bawden v. Taylor, 254 Ill. 464; Bacon v. Soule, 19 Cal. App. 428; Steinfeld v. Nielsen, 15 Ariz. 424; Shaw v. Cole Manufacturing Company, 132 Tenn. 210; Haverland v. Lane, 89 Wash. 557.

also declared that they were unable to find any *special facts* in the case.[45] In another of these cases, the court expressed a willingness to be bound by the rule in *Strong* v. *Repide,* but decided that they could not apply the rule in the case at bar inasmuch as the plaintiff was a director and was therefore on an equal footing with the defendant.[46] The fifth case in this group declared that the relation of shareholder and director was not involved and that the parties to the cause were dealing as any other individuals.[47] In fact, there is not one jurisdiction where the question has before been undecided that has expressed a willingness to follow the general rule as laid down by the older line of authorities.[48]

Six of the eight cases imposing a liability upon the purchasing director have admitted that in general there is no fiduciary relation between director and individual shareholder, but have found facts sufficient to take the instant case out of the operation of the general rule.[49] It seems that if the director sends a secret agent to the shareholder for the purpose of purchasing his stock and the shareholder then comes to the director for further information, the director is bound to reveal all facts within his knowledge relative to the probable future value of the stock.[50] A like duty will result if the director, in furtherance of a preconceived plan to buy in all the stock of the corporation, takes active steps to deceive the shareholders as to the real value of their stock.[51] The writer submits that such cases could more properly be decided on the ground of actual fraud than upon any relation between shareholder and director.[52] And like-

[45] Bawden v. Taylor, 254 Ill. 464, following, Hooker v. Midland Steel & Iron Company, 215 Ill. 444; Shaw v. Cole Manufacturing Company, 132 Tenn. 210, following, Deaderick v. Wilson, 8 Baxt. (Tenn.) 108; and, Haverland v. Lane; 89 Wash. 557, following, O'Neile v. Ternes, 32 Wash. 528.

[46] Steinfeld v. Nielsen, 15 Ariz. 424.

[47] Bacon v. Soule, 19 Cal. App. 428.

[48] See note 4, *supra.*

[49] George v. Ford, 36 App. Dist. Col. 315; Black v. Simpson, 94 S. Car. 312; Gadsden v. Bennetto, 23 Manitoba L. Rep. 33; Allen v. Hyatt, 17 Dom. L. Rep. 7; Poole v. Camden, 79 W. V. 310; Bollstrom v. Duplex Power Car Company, 208 Mich. 15, 175 N. W. 492.

[50] Strong v. Repide, 213 U. S. 419; Poole v. Camden, 79 W. V. 310; Bollstrom v. Duplex Power Car Company, 208 Mich. 15, 175 N. W. 492, (although this point was not noted in the opinion).

[51] Black v. Simpson, 94 S. Car. 312; Strong v. Repide, 213 U. S. 419.

[52] Traer v. Clewes, 115 U. S. 528, 6 Sup. Ct. Rep. 155, 29 L. Ed. 467; Morrison v. Snow, 26 Utah 247, 72 Pac. 924.

wise, the intentional concealment by a director of the fact that he is the real purchaser would warrant a finding of actual fraud.[53] But curiously enough, several of the courts seem to have been so impressed with the opportunity to find exceptions to the old rule that they entirely overlooked the elements of actual fraud in the case.[54]

The fact that the director first sought out the shareholder for the purpose of buying his stock has frequently been made the basis for finding an exception.[55]

The nature of the corporation itself has been seized upon by a number of the courts for this purpose. For example, in the case of a "closed" corporation where the buyer and seller of the stock are the only shareholders, courts have invariably held that a fiduciary relation existed between them[56] and have held transfers of stock under such circumstances to the same standard of good faith as transactions between partners.[57] And this seems to be the correct result; for although the relation between shareholder and director is not generally so intimate as that between partners, still, as a matter of common experience, there is no essential difference between a closed corporation with but few shareholders and the ordinary partnership except the mere fact of incorporation. If the corporation is inactive—not a *going* concern—so that the shareholders have no opportunity to acquaint themselves with the facts by an inspection of the company's books, this has been held to place the director in such an unusual position of superiority in dealing with the shareholder that he is bound to make a disclosure.[58] And likewise, where the purchasing director is the majority stockholder, his natural superiority over the shareholder is coupled with a duty to disclose.[59]

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[53] George v. Ford, 36 App. Dist. Col. 315; Poole v. Camden, 79 W. V. 310; Bollstrom v. Duplex Power Car Company, 208 Mich. 15, 175 N. W. 492; Strong v. Repide, 213 U. S. 419.

[54] Poole v. Camden, 79 W. V. 310; Bollstrom v. Duplex Power Car Company, 208 Mich. 15; Strong v. Repide, 213 U. S. 419.

[55] George v. Ford, 36 App. Dist. Col. 315; Gadsden v. Bennetto, 23 Manitoba L. Rep. 33, 9 Dom. L. Rep. 719; Allen v. Hyatt, 17 Dom. L. Rep. 7; Poole v. Camden, 79 W. V. 310; Strong v. Repide, 213 U. S. 419.

[56] George v. Ford, 36 App. Dist. Col. 315; Gadsden v. Bennetto, 23 Man. L. Rep. 33; Strong v. Repide, 213 U. S. 419.

[57] Griffith v. Owen, [1907] 1 Ch. 195; Anderson v. Lemon, 4 Seld. (N. Y.) 236.

[58] Bollstrom v. Duplex Power Car Company, 208 Mich. 15; Strong v. Repide, 213 U. S. 419.

[59] George v. Ford, 36 App. Dist. Col. 315; Strong v. Repide, 213 U. S. 419.

If the undisclosed fact consists of a single transaction which will naturally cause a rise in the value of the stock, such as sale of the entire corporate property at an advantageous price, the director is bound to disclose this fact before he can safely buy in shares.[60] Here too the director is in a position which, by reason of his peculiar knowledge, is naturally superior to that of the shareholder, and the transaction is one which the shareholder could not possibly discover through any other oracle than his director.

If the relation of principal and agent exists between the shareholder and the purchasing director, it has been held that there is a fiduciary relation between them,—for example, where the shareholder gives the director a power of attorney to sell his stock.[61] But such cases could have been decided on the ground of agency alone and without reference to the relation of shareholder and director, for there is always a fiduciary relation between principal and agent.[62] However, the recent decisions with one accord have heralded the additional element of agency as an exception to the general rule relating to dealings between director and shareholder. And one case seems to have gone so far to find some basis for taking the case out of the general rule that agency was found where in fact no agency existed.[63] The reasoning of the court was that, although the directors in their capacity as such are not the agents of the individual shareholders, still, if they appoint themselves a committee to bring in proposals for the transfer of the company's entire property, they are the agents of the individual shareholders in this respect. Now, accepting the court's hypothesis, that there is no relation of principal and agent between director and shareholder, the mere act of the directors in appointing themselves agents could not have had that effect ipso facto. It is one of the cardinal principles of agency that the relation can exist only at the will and by the act of the principal.[64]

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[60] George v. Ford, 36 App. Dist. Col. 315; Allen v. Hyatt, 17 Dom. L. Rep. 7; Gadsden v. Bennetto, 23 Manitoba L. Rep. 33; Strong v. Repide, 213 U. S. 419.

[61] George v. Ford, 36 App. Dist. Col. 315; Allen v. Hyatt, 17 Dom. L. Rep. 7.

[62] Kimball v. Ranney, 122 Mich. 160, 80 Amer. St. Rep. 548, 46 L. R. A. 403, 80 N. W. 992.

[63] Gadsden v. Bennetto, 23 Manitoba L. Rep. 33, 9 Dom. L. Rep. 719.

[64] 1 Mechem, Agency, [Ed. 2] § 210; Pole v. Leask, 33 L. J. Eq. 155; McGoldrick v. Willits, 52 N. Y. 612.

The report of the case discloses no act on the part of the shareholders, as principals, from which it could be inferred that they appointed the committee of directors their own agents. Nor could any agency be established through the acquiescence of the shareholders[65] in the acts of the committee, for it affirmatively appears that the shareholders did not even know of the existence of the committee before parting with their shares.

A fair inference from the foregoing discussion would seem to be that the recent decisions show a marked tendency coupled with a desire to break away from the old rule that the purchasing director owes no duty to disclose. The rule seems to be wearing away under the process of judicial decision in the same manner as many other of the more arbitrary rules of the common law.[66]

No doubt, the doctrine of *special facts* has led to just results in the individual cases decided under it. However, it leads to uncertainty in the law. It is as essential that law should be certain as that it should be flexible and just in individual cases.[67] To correlate all the *special facts* into one fundamental principle upon which all cases could be determined would seem to be an impossible task. Perhaps no more definite principle can be devised than that advanced by Pomeroy[68] and Perry[69] as the fundamental guide post for all cases

[65] 1 MECHEM, AGENCY, [Ed. 2] § 289; Fowlds v. Evans, 52 Minn. 551.

[66] For examples, see, Rylands v. Fletcher, L. R. 3 H. L. 330, distinguished by Nichols v. Marsland, L. R. 2 Ex. Div. 1; Box v. Jubb, L. R. 4 Ex. Div. 76; and also, Festing v. Allen, 12 Mees. & W. 279, distinguished by Astley v. Micklethwait, 15 Ch. Div. 59.

[67] "*Optima est lex, quae minimum relinquit arbitrio judicias; optimus judex, qui minimum sibi.*" BACON, APHORISMS, 46; 1 KENT, COMM. 475-8; 1 BLACKSTONE, COMM. 62.

[68] "Whenever two persons stand in such relation that, while it continues, confidence is reposed by one, and the influence which necessarily grows out of that confidence is possessed by the other, and this confidence is abused, or the influence is exerted to obtain an advantage at the expense of the confiding party, the person so availing himself of his position will not be permitted to retain the advantage, although the transaction could not have been impeached if no such confidential relation had existed." 2 POMEROY EQ. JUR. [Ed. 4], § 956; Keith v. Kellam, 35 Fed. 243, 246.

[69] "Whenever two persons stand in such relation that confidence is necessarily reposed by one, and the influence necessarily growing out of that fact is possessed by the other, and this confidence is abused or the influence is exerted to obtain an advantage at the expense of the confiding party, the party

involving fiduciary relationships. But this is admittedly one of the most ill-defined and elastic principles of the law.[70] To decide questions involving the duty of the purchasing director on the basis of any such rule would, therefore, seem to be relegating the determination of whether or not there is a fiduciary relation to the domain of fact by severing from the case all consideration of the legal relation of shareholder and director. There is clearly as much reason for well-defined rules in the transfer and sale of stock as there is in the case of negotiable instruments. The majority of the courts, therefore, seem to be confronted with this interesting dilemma: By clinging to the old rule that there is no fiduciary relation between director and shareholder, they have a clearly defined rule which leads to unjust results in the great majority of cases where it is applied; by finding exceptions to this rule and following the *special facts* doctrine, they may reach just results in individual cases, but clearness and precision in the law are sacrificed.

In view of the foregoing discussion, the writer submits that only two of the recent decisions have followed the correct principle[71] by following the lead of the earlier Georgia[72] and Kansas[73] decisions. Both confusion and injustice seem to be avoided by starting with the premise that there is always a fiduciary relation between director and shareholder[74] in the purchase by the director of the shareholder's stock.

HAROLD R. SMITH.

University of Michigan Law School.

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so availing himself of his position will not be permitted to retain the advantage." 1 PERRY, TRUSTS, [Ed. 5] § 209; Bohm v. Bohm, 9 Col. 100.

[70] "Courts of equity have carefully refrained from defining the particular instances of fiduciary relations in such manner that other and perhaps new cases might be excluded." 2 POMEROY, EQ. JUR. [Ed. 4] § 957.

[71] Jacquith v. Mason, 99 Neb. 509; Dawson v. National Life Insurance Company, 176 Iowa 362.

[72] Oliver v. Oliver, 118 Ga. 362.

[73] Stewart v. Harris, 69 Kan. 498.

[74] That the fiction of the corporate entity will not stand in the way of such a principle, see, 27 YALE L. JOUR. 731.