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Federal Antitrust Law - Stockholders' Remedies for Corporate Injury Resulting from Antitrust Violations: Derivative Antitrust Suit and Fiduciary Duty Action

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COMMENTS

FEDERAL ANTITRUST LAW — STOCKHOLDERS' REMEDIES FOR CORPORATE INJURY RESULTING FROM ANTITRUST VIOLATIONS: DERIVATIVE ANTITRUST SUIT AND FIDUCIARY DUTY ACTION — The question of what remedies are available to a stockholder whose corporation has been injured or is threatened with injury by acts violative of the federal antitrust laws[1] is largely unexplored. The staggering fines suffered by a number of corporations in the recent electrical industry criminal antitrust convictions[2] demonstrate, however, that the question is both timely and important. Moreover, its answer could have a great impact both upon the means of protecting corporate minority rights[3] and upon the means of private enforcement of the federal antitrust laws.[4] The stockholders' derivative suit[5] affords

1 The most important of these are the Sherman Act, 26 Stat. 209 (1890), as amended, 15 U.S.C. §§ 1-7 (1958); the Clayton Act, 38 Stat. 730 (1914), as amended, 15 U.S.C. §§ 12-27, 29 U.S.C. § 52 (1958); and the Federal Trade Commission Act § 5, 38 Stat. 719 (1914), as amended, 15 U.S.C. § 45 (1958). This comment deals only with problems raised by stockholders' actions based on violation of the federal antitrust laws. It should be noted, however, that such actions might also be predicated on the violation of state antitrust statutes. See, *e.g.*, DiTomasso v. Loverro, 250 App. Div. 206, 293 N.Y.S. 912 (1937), *aff'd*, 276 N.Y. 551, 12 N.E.2d 570 (1938).

2 Twenty indictments under the Sherman Act were returned, involving most of the nation's major electrical industry corporations. TRADE REG. REP. (1960 Trade Cas.) ¶ 45,060, Cases 1496A, 1498, 1500, 1502, 1504, 1506, 1507, 1517, 1519, 1521, 1523, 1525, 1527, 1529, 1539, 1541, 1548, 1550, 1558, 1566. Convictions were entered and sentences imposed by the United States District Court for the Eastern District of Pennsylvania on February 6 and 7, 1961. N.Y. Times, Feb. 8, 1961, p. 16, cols. 4-6. The General Electric Company, illustratively, was fined a total of $252,500. *Ibid.* The potential loss, however, is much higher, since the government and other parties allegedly injured by the illegal practices have already started to institute treble damage actions against the convicted corporations. *E.g.*, United States v. General Electric Co., TRADE REG. REP. (1961 Trade Cas.) ¶ 45,061, Case 1596 (E.D. Pa. 1961).

3 "We recognize that defense of a derivative suit [under the federal antitrust laws] . . . may be hard and expensive. But no substitute method of minority corporate supervision has yet been developed. . . ." Gottesman v. General Motors Corp., 268 F.2d 194, 198 (2d Cir. 1959) (Clark, J.). See generally Glenn, *The Stockholder's Suit — Corporate and Individual Grievances*, 33 YALE L.J. 580 (1924).

4 See generally Note, 66 YALE L.J. 413 (1957); 52 COLUM. L. REV. 1069 (1952).

5 This comment is directed toward stockholder remedies for injury to the corporation. The derivative suit treated in the text is the appropriate remedy in this regard. To be distinguished from the derivative suit is the stockholder's private suit, whereby the stockholder, either individually or as a representative of all stockholders as a class, sues for injury to *himself* as a stockholder. See 13 FLETCHER, PRIVATE CORPORATIONS §§ 5908, 5911 (perm. ed. rev. vol. 1961). It is sufficient here to note that neither the individual nor representative stockholders' suit will lie under the federal antitrust laws where predicated on injury to his corporation. It has been uniformly held that the indirect loss the stockholder suffers from a wrong to the corporation — the reduction in the value of his stock and potential share in the corporate assets — is not injury to his "business or property" which would justify a treble damage action under § 4 of the Clayton Act, 38 Stat. 731 (1914), 15 U.S.C. § 15 (1958). Peter v. Western Newspaper Union, 200 F.2d 867 (5th Cir. 1953). Nor is it "threatened loss or damage" justifying relief under section 16 of that act, 38 Stat. 731 (1914), 15 U.S.C. § 26 (1958). Continental Sec. Co. v. Michigan Cent. R.R., 16 F.2d 378 (6th Cir. 1926). That the plaintiff stockholder owns all the stock

two remedies which deal with these two points respectively.[6] There are two general types of derivative action. One lies where the corporation has a right of action against any party, within or without the corporate structure, but is unable or unwilling to assert that right.[7] This form of derivative suit could be brought under the federal antitrust laws for the various forms of relief specified therein against any party, either within or without the corporation, whose violation of those laws injures the corporation.[8] The second type of derivative action lies when any of those persons in control of the corporation act inimically to its interests, in breach of their fiduciary duties to the corporation, to hold them personally liable to it for the injuries resulting therefrom.[9] Such a derivative suit could be brought against directors or officers of the corporation to hold them personally liable to it for injuries it sustains by reason of their having violated or caused the corporation to violate the federal antitrust laws in breach of that fiduciary duty, or to restrain such violations.[10] It is with these two actions that this comment is concerned.[11]

I. STOCKHOLDERS' DERIVATIVE SUITS UNDER THE FEDERAL ANTITRUST LAWS

A. *The Law Prior to 1953*

From the time private parties were given the power under the federal antitrust laws to enjoin the violation of those laws, the stockholders' derivative suit has apparently been an appropriate

does not change the result. Westmoreland Asbestos Co. v. Johns-Manville Corp., 30 F. Supp. 389 (S.D.N.Y.), *adhered to,* 32 F. Supp. 731 (S.D.N.Y. 1939), *aff'd,* 113 F.2d 114 (2d Cir. 1940). See Annot., 139 A.L.R. 1017 (1942); Note, 5 STAN. L. REV. 480 (1953). Of course, a stockholder can recover personally for any individual loss from an antitrust violation which also happens to injure his corporation. Ritchie v. McMullen, 79 Fed. 522 (6th Cir. 1897). By hypothesis, individual and representative private suits do not lie to remedy breaches of fiduciary duty to the corporation discussed in section III of this comment.

[6] See generally 13 FLETCHER, *op. cit. supra* note 5, §§ 5850-6045.

[7] *E.g.,* Greenwood v. Union Freight R.R., 105 U.S. 13 (1881). See 13 FLETCHER, *op. cit. supra* note 5, §§ 5850-52, 5951.

[8] *E.g.,* Fanchon & Marco, Inc. v. Paramount Pictures, Inc., 202 F.2d 731 (2d Cir. 1953). See 13 FLETCHER, *op. cit. supra* note 5, § 5929.

[9] *E.g.,* Ashwander v. Tennessee Valley Authority, 297 U.S. 288 (1935). See 13 FLETCHER, *op. cit. supra* note 5, §§ 5850-52, 5951.

[10] *E.g.,* Simon v. Socony-Vacuum Oil Co., 179 Misc. 202, 38 N.Y.S.2d 270 (Sup. Ct. 1942), *aff'd mem.,* 267 App. Div. 890, 47 N.Y.S.2d 589 (1944).

[11] It is important to distinguish these two stockholders' derivative suit remedies which arise out of the violation of statutes, such as the federal antitrust laws, which do not expressly create stockholder actions, from an action under a provision of a statute that does in terms create such a remedy. An example of the latter is section 16(b) of the Securities Exchange Act of 1934, 48 Stat. 896 (1934), 15 U.S.C. § 78p(b) (1958).

vehicle to obtain injunctive relief.[12] But the same was not true with respect to the treble damage remedy. Due to the niceties of the historical distinction between law and equity it was established, by two early Supreme Court cases, that a stockholders' derivative suit would not lie to recover treble damages under the antitrust laws. In 1916 Mr. Justice Holmes closed the door in *Fleitman v. Welsbach St. Lighting Co.*[13] by holding that the treble damages provision was a legal remedy and would not lie in an equitable derivative suit which would deprive the defendants of their right to a jury trial on that issue. Mr. Justice Brandeis locked and bolted the door a year later in *United Copper Sec. Co. v. Amalgamated Copper Co.*[14] by holding that a derivative action is purely equitable and that a plaintiff could not avoid the impact of the *Fleitman* case by attempting to bring such an action on the law side. Thus an impasse was reached which lasted until 1953.

B. *The Law Since 1953*

The procedural merger of law and equity was effected by the Federal Rules of Civil Procedure in 1939.[15] The first stockholders' derivative suit to seek treble damages under the federal antitrust laws after that date was *Fanchon & Marco v. Paramount Pictures*,[16] which came before the Second Circuit in 1953. The trial court dismissed the treble damage count, holding the Federal Rules to be of no avail since the issue of treble damages was "substantive" and therefore unaffected by the new rules.[17] The Second

[12] Fanchon & Marco, Inc. v. Paramount Pictures, Inc., 202 F.2d 731 (2d Cir. 1953) (dictum). The *Fanchon & Marco* case cites no prior case in which a derivative suit was brought for injunctive relief under the federal antitrust laws and no prior cases have been found. It has been asserted [Note, 5 STAN. L. REV. 480, 483 (1953)] that such suits would not lie prior to the *Fanchon & Marco* decision, but the author cites only private stockholder action cases, which are wholly inapposite. See note 5 *supra*. A stockholder suing in the right of his corporation for threatened injury to the corporation would seem to qualify as a "person [or] . . . corporation . . . threatened [by] . . . loss or damage by a violation of the antitrust laws," 38 Stat. 737 (1914), 15 U.S.C. § 26 (1958), and the difficulties encountered in seeking the treble damage remedy (see text accompanying note 13 *infra*) would seem to present no problem with regard to the equitable injunctive remedy. In any event, the *Fanchon & Marco* case and every subsequent derivative suit which has sought injunctive relief have held that such relief is now obtainable in a derivative action. Ramsburg v. American Inv. Co., 231 F.2d 333 (7th Cir. 1956); Schechtman v. Wolfson, 141 F. Supp. 453 (1956), *aff'd*, 244 F.2d 537 (2d Cir. 1957).

[13] 240 U.S. 27 (1916).

[14] 244 U.S. 261 (1917).

[15] FED. R. CIV. P. 2.

[16] 202 F.2d 731 (2d Cir. 1953); 52 MICH. L. REV. 155 (1953); 49 NW. U.L. REV. 383 (1954); Annot., 36 A.L.R.2d 1345 (1954).

[17] Fanchon & Marco, Inc. v. Paramount Pictures, Inc., 107 F. Supp. 532 (S.D.N.Y. 1952), 52 COLUM. L. REV. 1069 (1952), *rev'd*, 202 F.2d 731 (2d Cir. 1953).

Circuit reversed, holding that the difficulty could easily be surmounted by trying the issue of the plaintiff stockholders' right to sue to the judge and the question of damages to the jury. This sound result has been followed without dissent in all subsequent actions[18] and now seems to be settled law.

II. Limitations of Stockholders' Derivative Suit Under the Federal Antitrust Laws

The area under consideration involves the interplay of two relatively discrete bodies of law: corporation law and federal antitrust law. When the various requirements of corporate and antitrust law are taken into consideration, the apparently broad sweep of the *Fanchon & Marco* case will be found to be limited to cases involving a rather narrow fact situation.

A. *Suits To Redress Corporate Injury Resulting From Anti-Competitive Effects of Antitrust Violation*

1. *Where Person Causing Violation Does Not Dominate Corporation.* When the corporation has a cause of action under the antitrust laws against one or more third parties who in no way dominate the corporation and its management, the decision whether to assert that cause of action would ordinarily be one solely within the discretion of the corporation's directors; assertion of the cause of action could be compelled by means of the stockholders' derivative suit only if it could be shown that this discretion had been abused.[19] When it is the corporation itself which has committed the antitrust violation, the corporation would have no cause of action under the antitrust laws for the simple reason that it has suffered no injury within the meaning of those laws.[20] The injurious effects of the anti-competitive acts in question are felt by the victims—competitors and the consuming public—not by their author.

18 Rogers v. American Can Co., 187 F. Supp. 532 (D.N.J. 1960); Gottesman v. General Motors Corp., 171 F. Supp. 661 (S.D.N.Y.), *petition for interlocutory appeal denied*, 268 F.2d 194 (2d Cir. 1959); Kogan v. Schenley Indus., Inc., 20 F.R.D. 4 (D. Del. 1956); Gomberg v. Midvale Co., 157 F. Supp. 132 (E.D. Pa. 1955) (dictum). The recent developments concerning derivative suits have not, of course, altered the rule that individual and representative stockholders' suits will not lie under the federal antitrust laws. Bookout v. Schine Chain Theatres, 253 F.2d 293 (2d Cir. 1958). See note 5 *supra*.

19 13 Fletcher, Private Corporations §§ 5945-60 (perm. ed. rev. vol. 1961). The derivative suit is most often available and necessary where the wrongdoer against whom the corporation has a cause of action dominates the corporation and thereby blocks the corporation's bringing suit. *Id.* § 5945. See also Koster v. Lumbermen's Mut. Cas. Co., 330 U.S. 518, 522-23 (1946) (dictum).

20 See text accompanying notes 24-30 *infra*.

2. *Where Person Causing Violation Dominates Corporation.* Where, however, the corporation is injured by anti-competitive acts for which persons are responsible who also dominate or control the corporation, the stockholders' derivative suit under the antitrust laws will be available to redress this injury. The *Fanchon & Marco* case itself arose in such a situation. There *A* corporation and *B* corporation formed *C* corporation, each taking back fifty percent of *C*'s stock and each naming two of *C*'s four directors. *B* corporation engaged in a restraint of trade by which *C* was victimized and made to forego profits. Corporation *A* then brought an action against *B* under the antitrust laws for treble damages and for an order enjoining *B* from voting its stock in *C*. *A*'s petition contained three counts, all based upon the same antitrust violation: (1) a claim by *A* individually in its capacity as stockholder in *C;* (2) a claim by *C* corporation itself; and (3) a claim by *A* as a stockholder of *C* suing derivatively to assert *C*'s claim. The first count was dismissed under the familiar rule that a stockholder's private action does not lie under the antitrust laws.[21] The second was likewise rejected because *A* could not authorize suit in *C*'s corporate name without the concurrence of *B* and since *B* was defendant in the suit, such concurrence was not forthcoming. But the third count, asserting a derivative right of action as a stockholder of *C*, was upheld. The injury to corporation *C* caused by defendants' conduct was direct and of the very type the antitrust laws were designed to prevent or redress. And a derivative suit under those laws was the appropriate — indeed, the only — way in which to invoke their protection. Because the wrongdoer itself controlled the management of the injured corporation, the latter was otherwise powerless to assert its cause of action.

Thus a derivative action *under* the federal antitrust laws to redress corporate injury flowing from the *anti-competitive effects* of an antitrust violation will be available only where one or more of the violators dominates the plaintiffs' corporation. The *Fanchon & Marco* case and all subsequent actions[22] for this type of injury have shared this factual situation.

21 See note 5 *supra.*

22 Ramsburg v. American Inv. Co., 231 F.2d 333 (7th Cir. 1956); Rogers v. American Can Co., 187 F. Supp. 532 (D.N.J. 1960); Gottesman v. General Motors Corp., 171 F. Supp. 661 (S.D.N.Y.), *petition for interlocutory appeal denied,* 268 F.2d 194 (2d Cir. 1959); Kogan v. Schenley Indus., Inc., 20 F.R.D. 4 (D. Del. 1956); Gomberg v. Midvale Co., 157 F. Supp. 132 (E.D. Pa. 1955) (dictum).

B. Suits To Redress Corporate Injury Resulting From Legal Consequences of Corporation's Own Violation of Antitrust Laws

All that has gone before has concerned corporate losses resulting when the corporation is the *victim* of an antitrust violation. But corporate injury can also result indirectly from an antitrust infringement when the corporation is itself the violating party. The corporation is then susceptible to losses in the form of fines, single damages, treble damages, and litigation expenses assessed or incurred in suits brought against it by the government, by private parties, or by both, whether terminated by judgment, consent decree, or settlement.[23] Of course, such losses do, in a broad sense, arise out of an antitrust infringement. The question then arises whether a stockholder of the guilty corporation could bring a derivative action *under* the antitrust laws to make the corporation whole by holding liable for the resulting injury the directors or officers who caused the corporation to violate those laws. Several considerations seem to indicate that such a suit would not be available in this situation.

The federal antitrust laws provide two exclusive remedies to private parties: (1) an action for treble damages in favor of "any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws,"[24] and (2) injunctive relief "against threatened loss or damage by a violation of the antitrust laws."[25] The injury or damage contemplated by the statutes has been held to be only such as directly flows from injury to the competitive system in that sector of the economy at which the illegal acts are aimed.[26] The classic statement of this rule is

23 Injunctions against further illegal practices and divestiture of assets the holding of which has been found illegal complete the possible consequences attendant on antitrust infringement. See Clayton Act § 11, 38 Stat. 734 (1914), as amended, 15 U.S.C. § 21 (1958), and Clayton Act § 16, 38 Stat. 737 (1914), 15 U.S.C. § 26 (1958). Since these remedies merely return the corporation to the *status quo* before the violation, no "loss" is incurred in the sense in which that word is used in this discussion.

24 38 Stat. 731 (1914), 15 U.S.C. § 15 (1958).

25 38 Stat. 737 (1914), 15 U.S.C. § 26 (1958).

26 *E.g.*, Conference of Studio Unions v. Loew's, Inc., 193 F.2d 51 (9th Cir. 1951), *cert. denied*, 342 U.S. 919 (1952); Bookout v. Schine Chain Theatres, Inc., 253 F.2d 292 (2d Cir. 1958) (L. Hand, J.) (private action by stockholder for diminution in value of his stock resulting from antitrust violation to corporation); Productive Inventions, Inc. v. Trico Prods. Corp., 224 F.2d 678 (2d Cir. 1955) (suit by patentee for loss of royalties due to violations against licensee); Gomberg v. Midvale Co., 157 F. Supp. 132 (E.D. Pa. 1955) (private stockholder claim). For an excellent discussion of this rule by Chief Judge Yankwich, see Hess v. Anderson, Clayton & Co., 20 F.R.D. 466, 475-78 (S.D. Cal. 1957). Injury to consumers as well as to competitors is, of course, the type of direct injury at which the antitrust laws aim. Mandeville Island Farms, Inc. v. American Crystal Sugar Co., 334 U.S. 219, 235-36 (1948).

contained in *Conference of Studio Unions v. Loew's, Inc.*[27] There a conspiracy was alleged among the various "majors" of the motion picture industry aimed at destroying the various "independents" of the industry. Plaintiff labor union alleged that as a result of this antitrust violation its members were unable to obtain employment on as favorable conditions as had previously been possible. The court dismissed plaintiff's action for treble damages and injunctive relief because the injury alleged was not of the type contemplated by the antitrust laws. The court stated:

> "The [plaintiff's] . . . connection with the alleged illegal conspiracy is not such as would bring them within the contemplation of the anti-trust law. The entire import of the conspiracy, insofar as competitive conditions are concerned, is the attempt to destroy the Independents. . . . The damage alleged to have been suffered by appellants does not flow from any injury to the competitive situation. . . .
>
> "[I]n order to state a cause of action under the anti-trust laws a plaintiff must show more than that . . . the conspiracy was in restraint of trade and that an act has been committed which harms him. He must show that he is within that area of the economy which is endangered by a breakdown of competitive conditions in a particular industry. Otherwise he is not injured 'by reason' of anything forbidden in the anti-trust laws."[28]

The injury in the situation under discussion is believed to be of like nature. Rather than having been injured by the anti-competitive effects of its own acts, the corporation has suffered loss due to the legal consequences of having engaged in such acts. The injury — damages and penalties — is causally but not legally connected to the antitrust violation. In *Gomberg v. Midvale Co.*[29] stockholders sought in a derivative suit to enjoin their directors from consummating a proposed merger between the corporation and one of its competitors. Plaintiffs claimed that the merger would be in violation of the federal antitrust laws and would subject the corporation to the threat of loss from damages and penalties in potential civil and criminal antitrust actions against the corporation. Judge Ganey dismissed the claim, citing the *Loew's* case:

27 193 F.2d 51 (7th Cir. 1951), *cert. denied,* 342 U.S. 919 (1952).
28 *Id.* at 54-55.
29 157 F. Supp. 132 (E.D. Pa. 1955).

"In sum the injury which the [antitrust] laws envision is the injury to the economy of the plaintiff, by virtue of restrictions of trade or something that proximately flows from it. . . .

". . . The money which [plaintiffs' corporation] . . . may, in some future time, be required to pay as treble damages or penalties as the result of possible actions brought against them for violations of the antitrust laws, is not threatened harm or damages which proximately flow from the violations within the meaning of Section 16."[30]

By parity of reasoning, such damages and penalties when actually assessed are not the type injury to the corporation's business or property required by statute for imposition of treble damages.

Moreover, any recovery by the corporation under the antitrust laws would be in treble the amount of the prior fines or damages. In the case of fines this would mean that the directors would be forced to pay three times that which the court in the prior action had determined to be the appropriate penalty for the violations. With regard to treble damages recovered in a prior action, the effect would be to assess the directors nine times the damage caused. The former would over-penalize the directors; the latter would overcompensate the corporation. If the treble damage provision is compensatory in nature,[31] there is trebling because the unliquidated nature of the actual damages makes proof of their full amount almost impossible. Here, however, the maximum damages would be fixed and certain; no trebling would be necessary to approximate full compensation. Indeed, to treble already-trebled damages would be to render them punitive, contrary to the intent of Congress hypothesized above. Even if a contrary hypothesis is true — that treble damages were intended by Congress to be punitive in nature — a second trebling would unjustifiably increase the sanction which Congress had thus deemed proper to impose. Thus an action of this nature might well be foreclosed on the additional ground that it would be out of harmony with the remedial scheme established in the federal antitrust statutes.

A final consideration is that the antitrust laws do not seem intended as vehicles for the adjustment of intracorporate loss-bearing. Support for this conclusion seems evident in the fact that the

[30] *Id.* at 142. *Accord,* Fein v. Security Banknote Co., 157 F. Supp. 146 (S.D.N.Y. 1957).

[31] Vold, *Are Threefold Damages Under the Anti-trust Act Penal or Compensatory?* 28 Ky. L.J. 117 (1940).

antitrust laws contain separate and distinct provisions concerning violations by corporations, on the one hand, and by individual corporate officers, on the other.

Thus an action is not available *under* the antitrust laws by which a corporation can hold the responsible officers liable for losses flowing from the legal consequences of their acts which caused the corporation to violate the antitrust laws. An alternative remedy does, however, appear to be available. This alternative, which will be explored in the remainder of this comment, is directed specifically to the type of loss here involved, provides for single rather than treble damages, and is expressly designed to adjust intracorporate equities.

III. STOCKHOLDERS' DERIVATIVE FIDUCIARY DUTY ACTION AGAINST DIRECTORS OR OFFICERS VIOLATING OR CAUSING THEIR CORPORATION TO VIOLATE THE FEDERAL ANTITRUST LAWS

Directors and officers owe their corporation a fiduciary duty to promote its best interests and keep it from loss.[32] It is beyond the scope of this comment to cover all facets of this relationship and its consequences. Several features, only, are here material. Management owes the corporation a duty of reasonable care in the direction of its affairs.[33] It must refrain from engaging, or causing the corporation to engage, in illegal or ultra vires activities.[34] Violating or causing the corporation to violate a statute involves a breach of fiduciary duty if the director knew or should, in the exercise of reasonable care, have known that the statute would be violated.[35] A stockholders' derivative suit will generally lie to hold the directors personally liable to the corporation for all loss sustained by it which is causally connected with a statutory violation[36] and to restrain a prospective or continuing violation.[37]

[32] See generally 3 FLETCHER, PRIVATE CORPORATIONS §§ 990, 1100 (perm. ed. rev. vol. 1947).

[33] *E.g.*, Kavanaugh v. Commonwealth Trust Co., 223 N.Y. 103, 119 N.E. 237 (1918). See 3 FLETCHER, *op. cit. supra* note 32, §§ 1029-64.

[34] See 3 FLETCHER, *op. cit. supra* note 32, §§ 1021-28; BALLANTINE, CORPORATIONS §§ 65, 106 (1946).

[35] Blaustein v. Pan American Petroleum & Transp. Co., 263 App. Div. 97, 31 N.Y.S.2d 934 (1941); Alderman v. Alderman, 178 S.C. 9, 181 S.E. 897 (1935); Williams v. McDonald, 37 N.J. Eq. 409 (1883); STEVENS, CORPORATIONS § 155 (2d ed. 1949). The fact that the statute violated does not in terms provide for such liability is not controlling. Thompson v. Greeley, 107 Mo. 577, 17 S.W. 962 (1891). *Cf.* note 11 *supra*.

[36] *E.g.*, Coeur D'Alenes Lead Co. v. Kingsbury, 59 Idaho 627, 85 P.2d 691 (1938).

[37] *E.g.*, DiTomasso v. Loverro, 250 App. Div. 206, 293 N.Y. Supp. 912 (1937), *aff'd*, 276 N.Y. 551, 12 N.E.2d 570 (1938).

Three elements are necessary to establish such a cause of action: that the statute was violated, that the directors knew or should have known their acts were illegal, and that the corporation was thereby injured. This comment will explore whether such a "fiduciary suit" will lie when the statute violated is one of the federal antitrust laws.

A. *The Fiduciary Suit Based on the Antitrust Laws Distinguished From an Action Under the Antitrust Laws*

It is imperative at the outset to distinguish clearly between an action *under* the antitrust laws and an action against directors or officers for a breach of their fiduciary duty which is founded on their violation of the antitrust laws. An action *under* the antitrust laws lies exclusively within the jurisdiction of the federal courts.[38] Such an action seeks to vindicate a right created by a body of federal statutes and enforceable only in a federal court and to receive remedies provided by those statutes and no others.[39] A suit based on breach of fiduciary duty vindicates a right created by the common law of the state; the remedies are provided by state law and such suits lie primarily in state courts.[40] The federal antitrust laws are involved, if at all, only to the extent that their violation provides one substantive element of the state cause of action: the illegality of the acts complained of. Thus when the federal antitrust laws are relied upon merely to establish the element of illegality necessary to show a breach of fiduciary duty and not to seek recovery under the antitrust laws, no federal question is raised upon which to predicate federal jurisdiction.[41] Similarly, if a fiduciary suit is in a federal court on diversity grounds alone, the federal court applies state law and its use of the anti-

[38] Freeman v. Bee Machine Co., 319 U.S. 448 (1943); Blumenstock Bros. Advertising Agency v. Curtis Publishing Co., 252 U.S. 436 (1920); Kalmanash v. Smith, 291 N.Y. 142, 51 N.E.2d 681 (1943); McMaster v. Ford Motor Co., 114 S.C. 100, 103 S.E. 87 (1920); Gold Fuel Serv., Inc. v. Esso Standard Oil Co., 59 N.J. Super. 6, 157 A.2d 30 (Super. Ct. 1959); Clayton v. Farrish, 191 Misc. 136, 73 N.Y.S.2d 727 (Sup. Ct. 1947); Williamson v. Columbia Gas & Elec. Co., 27 F. Supp. 198 (D. Del.), *aff'd,* 110 F.2d 15 (3d Cir.), *cert. denied,* 310 U.S. 639 (1940); American Ref. Co. v. Gasoline Prods. Co., 294 S.W. 967 (Tex. Civ. App. 1927); Venner v. New York C. & H.R.R., 177 App. Div. 296, 164 N.Y.S. 626 (1917), *aff'd mem.,* 226 N.Y. 583, 123 N.E. 893, *cert. denied,* 249 U.S. 617 (1919).

[39] A. B. Small Co. v. Lamborn & Co., 267 U.S. 248 (1925); Meyer v. Kansas City So. R.R., 84 F.2d 411 (2d Cir.), *cert. denied,* 299 U.S. 607 (1936); Klein v. Lionel Corp., 138 F. Supp. 560 (D. Del.), *aff'd,* 237 F.2d 13 (3d Cir. 1956).

[40] Meyer v. Kansas City So. R.R., *supra* note 39.

[41] *Ibid.* See also Annot., 14 A.L.R.2d 1185 (1950).

trust violation is limited to the same extent the state court's would be.[42]

B. *The Effect of a Prior Adjudication of Illegality Under the Act*

It has been noted above that the plaintiff stockholder must prove three elements to maintain his fiduciary action: violation of the antitrust laws, the particularized scienter or negligence required, and causally-connected damages. What would be the effect upon the proof of these three elements of a prior adjudication in a federal court of the illegality of the acts complained of in the fiduciary action?

1. *The Issue of Illegality.* By far the greatest impediment to the successful maintenance of a fiduciary action for violation of the antitrust laws has been the difficulty, real or imagined, in establishing the requisite element of illegality by proof in a state court of the violation of federal statutes.[43] Since the plaintiff in the prior action could never be or represent the stockholders' corporation, the doctrine of collateral estoppel would not generally be available to make the prior adjudication of violation binding on the defendant directors on the issue of illegality.[44] It is true that the corporation is the real party in interest in the fiduciary action and that both the corporation and the directors and officers are likely to be joined as parties defendant in the antitrust action. It is further true that coparties can be later bound by collateral estoppel but only as to issues on which they took adverse positions.[45] By no means is the requirement of adverseness satisfied concerning the issue of violation of the antitrust laws as between the corpora-

[42] Gomberg v. Midvale Co., 157 F. Supp. 132 (E.D. Pa. 1955). This would also appear to be true where a derivative fiduciary suit is joined with an action *under* the federal antitrust laws which confers federal question jurisdiction on the federal court. *E.g.*, Gottesman v. General Motors Corp., 171 F. Supp. 661 (S.D.N.Y.), *petition for interlocutory appeal denied*, 268 F.2d 194 (2d Cir. 1959).

[43] See Gomberg v. Midvale Co., *supra* note 42 (applying Pennsylvania law); Clayton v. Farrish, 191 Misc. 136, 73 N.Y.S.2d 727 (Sup. Ct. 1947); Hoffman v. Abbott, 180 Misc. 590, 40 N.Y.S.2d 521 (Sup. Ct. 1943); Diamond v. Davis, 263 App. Div. 68, 31 N.Y.S.2d 582 (1941). Compare Simon v. Socony-Vacuum Oil Co., 179 Misc. 202, 38 N.Y.S.2d 270 (Sup. Ct. 1942), *aff'd mem.*, 267 App. Div. 890, 47 N.Y.S.2d 589 (1944).

[44] *Cf.* Kessler v. Fligel, 240 App. Div. 232, 269 N.Y. Supp. 664, *appeal dismissed*, 264 N.Y. 689, 191 N.E. 628 (1934). See generally Scott, *Collateral Estoppel by Judgment*, 56 HARV. L. REV. 1 (1942). The rule in California, however, would make the prior adjudication of illegality binding on the directors who were joined as defendants in the prior action. Bernhard v. Bank of America Nat'l Trust & Sav. Ass'n, 19 Cal.2d 807, 122 P.2d 892 (1942).

[45] RESTATEMENT, JUDGMENTS § 82 (1942); *Developments in the Law — Res Judicata*, 65 HARV. L. REV. 818, 860-61 (1952). *But see* 36 GEO. L.J. 441 (1948) which urges a contrary result, apparently overlooking the requirement of adverseness.

tion and its officers and directors joined as defendants in an antitrust action. Section 5 (a) of the Clayton Act[46] is likewise of no avail. That section provides that a judgment obtained by the United States in an antitrust action shall be prima facie evidence against the defendant in any action brought by any other party "*under* said [antitrust] laws" growing out of the adjudged violation.[47] But the fiduciary duty suit does not arise *under* the antitrust laws. As a practical matter, however, the prior adjudication will be most persuasive authority in the fiduciary suit. A state court must, in deciding an issue arising out of a federal statute, look to federal law.[48] The finding of a violation of the federal antitrust laws by a federal court in a prior action involving the same conduct by the same defendants would doubtless be most persuasive to the state court on the issue of illegality in the fiduciary action. However, the state court will not be able to rely upon a federal court determination of the antitrust violation issue as binding on it by res judicata or otherwise. The state court will therefore not entertain this type of action unless it conceives itself to possess the power to interpret the federal antitrust statutes.

2. *The Issue of State of Mind.* Where the alleged illegality consists of the violation of a statute, plaintiff must show that the director knew or should have known he was violating or causing the corporation to violate the act.[49] Actual intent to commit an act known to be illegal is always sufficient.[50] Where this intent is lacking, plaintiff must prove that had the director used reasonable care he would have known the act was prohibited.[51] The state of mind required to be shown to find a violation *under* the antitrust laws is often markedly different. Negligence is never a factor. The intent required to constitute a violation of most of the statutes' provisions is merely the general intent to do the act later held to

46 38 Stat. 731 (1914), as amended, 15 U.S.C. § 16 (1958).

47 *Ibid.* (Emphasis added.)

48 Gulf, C. & S.F. Ry. v. Moser, 275 U.S. 133 (1927); Cohens v. Virginia, 19 U.S. (6 Wheat.) 264 (1821). See also Note, 48 COLUM. L. REV. 943 (1948).

49 See cases cited in note 35 *supra*. Where the statute clearly and unambiguously relates to the duties of corporate officers or directors, there is authority to the effect that mere violation thereof conclusively establishes a breach of fiduciary duty. *E.g.*, Broderick v. Marcus, 152 Misc. 413, 272 N.Y. Supp. 455 (Sup. Ct. 1934). The federal antitrust statutes are not, of course, of this nature.

50 Alderman v. Alderman, 178 S.C. 9, 181 S.E. 897 (1935); Medford Trust Co. v. McKnight, 292 Mass. 1, 197 N.E. 649 (1935); Blaustein v. Pan American Petroleum & Transp. Co., 263 App. Div. 97, 31 N.Y.S.2d 934 (1941).

51 Simon v. Socony-Vacuum Oil Co., 179 Misc. 202, 38 N.Y.S.2d 270 (Sup. Ct. 1942), *aff'd mem.*, 267 App. Div. 890, 47 N.Y.S.2d 589 (1944).

be illegal.[52] This is demonstrably quite different from the intent to do an act known to be illegal.[53] In short, a prior adjudication of illegality not only is not binding, but also has no necessary relevance to the determination of the issue of intent or negligence in the fiduciary suit.[54] Negligence is material in one and immaterial in the other; "intent" is not necessarily required in either and to the extent it may be present in both, it may well be tested by different criteria.

3. *The Issue of Damages.* Breach of fiduciary duty is not actionable unless the corporation has suffered or is threatened with damage directly attributable thereto.[55] The treble damages, fines, and litigation costs incurred in a prior adjudication are clear, definite, and easily proved losses to the corporation. Since the breach alleged in the fiduciary action consists of precisely those acts which led to such losses in the prior antitrust action, they are not only recoverable but would usually constitute the upper limit of the recovery.[56] Indeed, this ability to recover the losses suffered by the corporation in a prior antitrust suit is the principal advantage which the fiduciary action has over the derivative suit under the antitrust laws which cannot recoup these losses. And while the stockholder may well not desire, by use of an antitrust suit, to plunge his corporation into antitrust litigation, when another has successfully done so it is clearly to the stockholders' interest to hold the delinquent directors or officers liable to the corporation for its resulting losses.

C. *Case Law on the Fiduciary Suit Involving an Antitrust Violation*

Relatively few cases have squarely presented the question whether a fiduciary action will lie where the breach of duty alleged

[52] Specific intent must be shown to make out an attempt to monopolize under § 2 of the Sherman Act, 26 Stat. 209 (1890), 15 U.S.C. § 2 (1958). United States v. Columbia Steel Co., 334 U.S. 495 (1948); Swift & Co. v. United States, 276 U.S. 311 (1928). For the other criminal provisions a general intent to do the illegal act is all that is required and it need not be shown that the defendant knew the act to be illegal at the time he committed it. United States v. General Instrument Corp., 87 F. Supp. 157 (D.N.J. 1949); United States v. United States Gypsum Co., 51 F. Supp. 613 (D.D.C. 1943).

[53] See text accompanying note 102 *infra.*

[54] *Cf.* Casey v. Woodruff, 49 N.Y.S.2d 625, 640 (Sup. Ct. 1944).

[55] *E.g.,* Diamond v. Davis, 263 App. Div. 68, 31 N.Y.S.2d 582 (1941). The *Diamond* case enunciated the damage requirement and said further that damage could not be inferred from the mere fact of violation of the federal antitrust laws.

[56] Clayton v. Farrish, 191 Misc. 136, 73 N.Y.S.2d 727 (Sup. Ct. 1947). *Cf.* Sellers v. Head, 261 Ala. 212, 73 So. 2d 747 (1954) (tax penalty); Coeur D'Alenes Lead Co. v. Kingsbury, 59 Idaho 627, 85 P.2d 691 (1938) (tax penalty); Hackner v. Van Wyck, 324 Ill. App. 521, 58 N.E.2d 315 (1944) (fine; nonsuit on technical pleading grounds).

consists solely of a violation of the federal antitrust laws. Such authority as there is, despite some confusion, indicates that the action is maintainable.

1. *The Early Federal Cases.* In 1914 the issue whether a violation of the federal antitrust laws constituted a breach of fiduciary duty which would support a stockholders' derivative suit based on traditional equitable principles, as distinct from an action based on antitrust laws themselves, was first raised in *De Koven v. Lake Shore & M.S. Ry.*[57] The plaintiff minority stockholder there sought to restrain the majority stockholders of his corporation from merging with competitors. One count of three was predicated on the ground that the merger would violate the Sherman Act. Despite its recognition of the fact that only the United States had, under the terms of the act, the power to enjoin its violation, the court held this count stated a good cause of action, reasoning:

> "The plaintiffs contend that the bill is not a suit in equity under the Sherman Act. . . . [This] contention is correct. The present suit is one by a dissenting minority stockholder to restrain the majority stockholders from accomplishing what is asserted to be an illegal or ultra vires act. It is, therefore, a well recognized species of general equitable jurisdiction, and not a mere statutory remedy conferred by the antitrust law. . . . [T]he fact that . . . [the Act provides a separate remedy of which he is unable to avail himself] cannot be held to deprive an individual of an equitable remedy which was open to him before and independent of the statute. . . . [T]hat the illegal or ultra vires act is made so only by the statute [cannot change the result]. . . . If it be an illegal or ultra vires act, however made so, a minority stockholder has . . . a . . . remedy of which he is not deprived by the creation of a statutory . . . remedy . . . of which he is not permitted to avail."[58]

This early case clearly and properly distinguished the essential difference between an action *under* the statute and one for breach of fiduciary duty founded on the violation of that statute. It properly recognized that a court's inability to grant relief under the former in no way precludes its maintenance of the latter since the rights sought to be vindicated and the relief sought spring from different sources. And, finally, it understood that their interrelation lies in the fact that proof of violation of the antitrust acts is a requisite of both. The confused state of the law in this

[57] 216 Fed. 955 (S.D.N.Y. 1914).
[58] *Id.* at 957-58.

area has resulted largely from a lack of appreciation by state courts of these several factors.

In 1931 the cases of *Guiterman v. Pennsylvania R.R.*[59] and *Hand v. Kansas City So. Ry.*[60] extended the reasoning of *De Koven* to fiduciary actions for damages resulting from alleged violations. Both actions were started in state courts and removed to the federal court. In both, *motions to dismiss were made on the ground that the state courts had no jurisdiction* to grant relief under the federal antitrust law and that therefore the federal court obtained none on removal. *Both motions were denied* for reasons illustrated by the court's language in *Hand:*

> " 'It is now settled law that the remedies provided by the [Sherman] Act . . . *for enforcing the rights created by it* are exclusive. . . .' This declaration, however, is of no present aid to defendants, for the reason that plaintiff is not here seeking to enforce a right created by that act. On the contrary, he is seeking merely to redress an injury to the corporate defendant as a result of an effort on the part of the defendant directors to accomplish a public wrong. There is therefore no occasion to measure plaintiff's remedial rights by the statutory penalties of the Sherman and Clayton Acts."[61]

The court in *Guiterman* made the implication express:

> "There is nothing . . . to warrant . . . the inference that the [Supreme Court has] excluded a state court from jurisdiction as to all rights which might relate to the Sherman Anti-Trust Act.
>
> "[T]he issue is whether the defendant directors committed an ultra vires act. . . . The particular ultra vires act alleged to have been committed arises out of the Sherman Act and the Clayton Act. The Supreme Court of the State of New York certainly has jurisdiction in causes in which stockholders charge directors with malfeasance. That such malfeasance may arise out of a violation of a federal statute should not deprive the state court of jurisdiction. . . .
>
> "I conclude, therefore, that the state court had jurisdiction over the subject-matter of this suit."[62]

In both the *Hand* and *Guiterman* cases, the federal district courts felt they had federal question jurisdiction because of the

[59] 48 F.2d 851 (E.D.N.Y. 1931).
[60] 55 F.2d 712 (S.D.N.Y. 1931).
[61] *Id.* at 713-14.
[62] Guiterman v. Pennsylvania R.R., 48 F.2d 851, 853, 855 (E.D.N.Y. 1931).

necessity to decide whether the federal antitrust laws had in fact been violated even though the actions were not brought *under* the antitrust laws. This proposition was expressly disapproved five years later by the Second Circuit in *Meyer v. Kansas City So. Ry.*[63] The *Meyer* case presented essentially the identical cause of action asserted in *Hand* and *Guiterman* and so the court, finding no diversity, dismissed the action for want of federal jurisdiction.[64] An analysis of these three cases would seem to indicate that the fiduciary suit is based on a theory of liability arising out of state common law, creating a remedy available in state courts, even though the illegal act on which it relies consists of a breach of a federal statute.

2. *The State Court Cases.* Of the few state court fiduciary suits which have been predicated on antitrust violations, several evidence an apparent inability on the part of the court or counsel to analyze correctly the issues involved in the action or to appreciate its potential utility. For example, the difficulty in *Hoffman v. Abbott,*[65] in which plaintiff was nonsuited, lay clearly with counsel's drafting of the three causes of action. He alleged, in substance, (1) that the directors had conspired with each other to effect a monopoly resulting in listed actual damages to the corporation, (2) that the corporation had been indicted for violation of the federal antitrust laws, and (3) that the directors knowingly had violated the Robinson-Patman Act.[66] Nowhere did plaintiff allege that the violations of the antitrust acts *themselves* constituted a breach of fiduciary duty. Therefore the court, without considering this possibility, nonsuited plaintiff since there was no other ground from which a breach of the directors' fiduciary duties could be implied. In *Diamond v. Davis*[67] counsel seemingly failed to plead sufficient facts to prove an alleged violation of the Robinson-Patman Act; the court properly held a consent decree obtained by the United States would establish neither the statutory violation nor the facts showing any injury flowed therefrom — two essential elements of the cause of action.

The most disturbing case is *Clayton v. Farrish.*[68] There it was alleged that the defendant directors caused the corporation to enter into a cartel arrangement. The corporation agreed to a consent

63 84 F.2d 411 (2d Cir.), *cert. denied,* 299 U.S. 607 (1936).
64 See also Annot., 14 A.L.R.2d 1185 (1950).
65 180 Misc. 590, 40 N.Y.S.2d 521 (Sup. Ct. 1943).
66 49 Stat. 1526 (1936); 15 U.S.C. § 13 (1958).
67 263 App. Div. 68, 31 N.Y.S.2d 582 (1941).
68 191 Misc. 136, 73 N.Y.S.2d 727 (Sup. Ct. 1947).

decree under the federal antitrust laws. As a result, the corporation suffered substantial injury in lost profits, fines, and litigation expenses. The plaintiff stockholder sought to hold the directors liable in the amount thereof. Two breaches of fiduciary duty were alleged: (1) that the directors had served the interests of the other corporation when these conflicted with those of their own corporations, and (2) that the acts were illegal because in violation of the antitrust laws. The defendants moved to dismiss on the grounds, *inter alia,* that the court was without jurisdiction of the subject matter because the suit was predicated upon the federal antitrust laws. The defendants urged in support of this motion that the state court was without jurisdiction to determine whether the directors' acts violated the antitrust acts and that a "determination by this court that the agreements in question did, in fact, contravene the federal antitrust laws is . . . a condition precedent to the granting of the relief demanded." To this contention the court, in denying the motion to dismiss, stated succinctly, "I do not agree. . . . Even after eliminating from . . . the complaint the *irrelevant* allegations that the cartel agreement violated the federal antitrust laws . . . the remaining allegations state a cause of action. . . ."[69] It is easy to agree with the court that the nonstatutory allegation stated a cause of action, that the ruling on the motion was correct in result, and that all the damages alleged including those directly attributable to the consent decree were proper elements of recovery. In view of the separate ground the statutory violation allegation was unnecessary, but was it "irrelevant"? The cases cited in support of the dictum do not sustain it.[70] The whole thrust of the court's reasoning is contained in this brief passage:

> "[L]iability cannot be imposed on defendants by this court merely because they violated the federal antitrust laws. The basis of their liability must be acts which fail to conform to their fiduciary duty. . . ."[71]

It is abundantly clear that the court either did not realize that a statutory violation *itself* could be a breach of duty or else, while

69 *Id.* at 146, 73 N.Y.S.2d at 737-38. (Emphasis added.)

70 The court relied principally on Kalmanash v. Smith, 291 N.Y. 142, 51 N.E.2d 681 (1943). That case is wholly inapposite for two reasons: (1) It was an action *under* the federal antitrust laws and so, of course, the state court had no jurisdiction. See text accompanying and cases cited in note 38 *supra.* (2) It was not a suit based on breach of fiduciary duty. Thus the court in *Clayton* failed to make the fundamental distinction described in section III-A of this comment.

71 Clayton v. Farrish, 191 Misc. 136, 153, 73 N.Y.S.2d 727, 744 (Sup. Ct. 1947).

accepting that principle, felt that a state court was without power to decide whether the directors' acts in fact violated a federal statute. If the former is true, the case may be dismissed as ill-considered.[72] However, the validity of the latter alternative should be examined, for this proposition was adopted by the court in *Gomberg v. Midvale Co.*[73] as a basis for decision. *Gomberg v. Midvale Co.*, as noted above, was a stockholders' derivative action to enjoin the common directors of their corporation and a competing corporation from consummating a proposed merger alleged to be violative of the federal antitrust laws. Relief was sought primarily under the laws themselves. But there was also diversity of citizenship and the stockholders prayed that the court retain jurisdiction if it found against them on the federal count and, sitting as a state court, restrain the merger as illegal under the federal antitrust laws and hence as an ultra vires act which, if permitted, would be in breach of the directors' fiduciary duty under state law. After holding against plaintiffs on the antitrust count, the court cavalierly disposed of the latter alternative contention in two sentences:

> "It is claimed that the sale of assets will violate the federal antitrust law and is therefore ultra vires. Since the acts herein complained of are primarily acts which only a federal court could take jurisdiction of . . . a Pennsylvania court would hold that redress if any would have to be relegated to the federal court under the antitrust laws."[74]

This statement is, or should be, wrong.

3. *Does a State Court Have the Power To Decide Whether Acts Violate a Federal Statute Where This is a Necessary Element in a State Cause of Action?* A state court has jurisdiction over the subject matter of a derivative action against directors and officers

[72] Investment Associates v. Standard Power & Light Corp., 29 Del. Ch. 225, 48 A.2d 501 (1946), *aff'd* 29 Del. Ch. 593, 51 A.2d 572 (1947), is believed to be subject to criticism on this ground. That case involved a derivative fiduciary duty action predicated on a violation of § 14 of the Securities Exchange Act of 1934, 48 Stat. 895 (1934), 15 U.S.C. § 78n (1958). It can be inferred from the report that it was urged upon the court that the statutory violation constituted a breach of fiduciary duty. The court, apparently failing to appreciate that fact, discussed only the question whether a private party could sue under the statute; this question it answered in the negative. While the answer given was correct, it was in response to the wrong question.

[73] 157 F. Supp. 132 (E.D. Pa. 1955).

[74] *Id.* at 142.

for breach of their fiduciary duty to the corporation.[75] When that breach is alleged to consist of a violation of the federal antitrust laws, such violation is, of course, an essential element of that subject matter.[76] It is only to supply this element of illegality to the state action that recourse is required to the federal statute.[77] No right created by that statute nor remedy provided thereby is sought. Can the declaration of illegality in the statute be separated from the rights and remedies which it creates? The acts themselves support an affirmative answer. Section 1 of the Sherman Act,[78] illustratively, simply provides that certain conduct "is declared to be illegal"; the rights and remedies flowing from the condition of illegality thus created are elsewhere specified. This condition of illegality attaches to the proscribed conduct regardless of those rights and remedies. A contract in restraint of trade does not vacillate between legality and illegality in proportion to its relative proximity to a federal courthouse.[79]

Of course, the existence of this condition of illegality must be judicially determined before a defendant can be made to suffer any consequences attaching to it. Does a state court, for the purposes of an action arising under its own law, have the power to adjudicate an issue by reference to the law of another jurisdiction, state, federal, or foreign? More specifically, does the state court, to supply the requisite element of illegality, have the power to adjudicate whether certain acts contravene a federal statute? The general statement of the question is answered affirmatively by reference to familiar principles of conflict of laws[80] and to the practice

[75] De Koven v. Lake Shore & M.S. Ry., 216 Fed. 955 (S.D.N.Y. 1914); Guiterman v. Pennsylvania R.R., 48 F.2d 851 (E.D.N.Y. 1931); Hand v. Kansas City So. Ry., 55 F.2d 712 (S.D.N.Y. 1931); Meyer v. Kansas City So. Ry., 84 F.2d 411 (2d Cir.), *cert. denied,* 299 U.S. 607 (1936); Diamond v. Davis, 263 App. Div. 68, 31 N.Y.S.2d 582 (1941); Simon v. Socony-Vacuum Oil Co., 179 Misc. 202, 38 N.Y.S.2d 270 (Sup. Ct. 1942), *aff'd mem.,* 267 App. Div. 890, 47 N.Y.S.2d 589 (1944).

[76] *E.g.,* Diamond v. Davis, *supra* note 75.

[77] *E.g.,* Meyer v. Kansas City So. Ry., 84 F.2d 411 (2d Cir.), *cert. denied* 299 U.S. 607 (1936).

[78] 26 Stat. 209 (1890), 15 U.S.C. § 1 (1958).

[79] Thus state courts have refused to enforce contracts found to be illegal because violative of the federal antitrust laws. See text accompanying and cases cited note 90 *infra.*

[80] There are limitations, of course, on the types of foreign statutes a court will *enforce.* For example, penal statutes and statutes designed solely to further the governmental interests of the enacting jurisdiction will not be enforced by a foreign forum. RESTATEMENT, CONFLICTS OF LAW §§ 610-11 (1934). These limitations, however, are inapplicable to the derivative fiduciary duty action because that suit does not seek to enforce the statute on whose violation it is predicated. See section III-A of this comment; compare text accompanying note 86 *infra. But see* Steckler v. Pennroad Corp., 44 F. Supp.

of the federal courts in diversity cases.[81] An affirmative answer to the specific question is indicated, for the *De Koven* and *Meyer* cases evidence not only that a court, state or federal, with equitable jurisdiction has the power to decide in a fiduciary suit whether the federal antitrust laws have been violated but also that this issue does not even raise a federal question. Moreover, a line of closely analogous authority also exists. It seems clear that a stockholders' derivative fiduciary suit will lie to hold directors or officers personally liable to their corporation for the amount of penalties assessed against it for violations of the federal tax statutes where the breach of fiduciary duty consists solely in the violation of those statutes.[82] Two state supreme courts have reached this result.[83] Since res judicata was not applicable in either case to make binding on the state courts the prior finding by the Internal Revenue Service of a violation of the federal statute, the power to readjudicate that issue and the exercise of that power by the state courts is implicit in their judgments.

The state court, then, has the *power* to adjudicate, for its own purposes, whether the federal antitrust statutes have been violated. And refusal to do so, therefore, could stem only from a reticence as a matter of policy to exercise that power. There are numerous examples of such policy-dictated self-restraint.[84] What policy factors are applicable with respect to the federal antitrust laws? The court might desire to effectuate a supposed intent of Congress

800 (E.D. Pa. 1942), *aff'd*, 136 F.2d 197 (3d Cir.), *cert. denied*, 320 U.S. 757 (1943) (dictum; applying state law). Compare Gilbert v. Burnside, 197 N.Y.S.2d 623 (Sup. Ct. 1959), which allowed a fiduciary suit based on a similar foreign state statute.

81 See Erie R.R. v. Tompkins, 304 U.S. 64 (1938).

82 Sellers v. Head, 261 Ala. 212, 73 So. 2d 747 (1954); Coeurs D'Alenes Lead Co. v. Kingsbury, 59 Idaho 627, 85 P.2d 691 (1938). See Lasser & Holzman, *Personal Liability of Directors for Section 102 Surtaxes*, The Controller, July, 1948, p. 342; 49 COLUM. L. REV. 394 (1949); 61 HARV. L. REV. 1058 (1948). A stockholders' derivative suit will lie to enjoin excessive accumulations of corporate earnings since such accumulations would violate section 531 of the Internal Revenue Code of 1954 and hence constitute a breach of the directors' fiduciary duty to the corporation. Gordon v. Elliman, 306 N.Y. 456, 119 N.E.2d 331 (1954); compare Knapp v. Bankers Sec. Corp., 230 F.2d 717 (3d Cir. 1956), holding such an action a private rather than a derivative suit.

83 Sellers v. Head, *supra* note 82; Coeur D'Alenes Lead Co. v. Kingsbury, *supra* note 82. *Cf.* Hackner v. Van Wyck, 324 Ill. App. 521, 58 N.E.2d 315 (1944).

84 Illustratively, the United States Supreme Court has uniformly refused to rule on state statutes in diversity cases until the highest court of the state has had an opportunity to do so. *E.g.*, Louisiana Power & Light Co. v. City of Thibodaux, 360 U.S. 25 (1959); Leiter Minerals, Inc. v. United States, 352 U.S. 220 (1957); Chicago v. Fieldcrest Dairies, Inc., 316 U.S. 168 (1942). This policy-based self restraint does not, of course, affect the court's ability or duty to take jurisdiction of the diversity suit. Meredith v. Winter Haven, 320 U.S. 228, 236 (1943).

that the remedies specified in the acts be exclusive.[85] But the fiduciary duty action is not a remedy for an antitrust violation. It is, rather, an intracorporate remedy to shift to the wrongdoer the injurious consequences of his wrong which would otherwise be ultimately borne by innocent, wronged parties. An analogy lies in the operation of the "negligence per se" rule in tort law.[86] There the plaintiff can rely on the fact of the defendant's violation of a criminal statute or ordinance to establish the element of negligence essential to his cause of action. And yet surely the legislature enacting the criminal statute conceived the state to be the only proper moving party and the sanctions provided in the statute to be the "exclusive remedies" for a violation thereof. The use of the statutes in both instances is not to give a remedy for their violation, but rather to supply a necessary element of a separate legal device designed to shift to the wrongdoer the injurious consequences of an act thereby made wrongful.[87] Another policy which arguably

85 The remedies specified in the federal antitrust laws are indeed the exclusive remedies for actions arising under those laws. See cases cited in note 39 *supra*. But this exclusivity relates only to actions under the laws, and can have no legitimate effect on remedies—such as the fiduciary duty suit—which exist independently of them.

"Nothing is found in the federal anti-trust statutes expressly or impliedly providing exclusive jurisdiction in federal courts respecting violations of individual, private rights. The statutes provide only two civil remedies, *i.e.* injunctive relief . . . or treble damages. . . . These remedies are not available to plaintiff in a state court action because they are cognizable in federal courts exclusively, and the state court has no jurisdiction to give relief thereon. But these provisions relate to remedies. It is unreasonable to maintain that the anti-trust statutes were intended to exclude persons who had common law rights, arising from something also forbidden or declared to be unlawful by the acts, from pursuing their remedies in a proper jurisdiction. . . .

"I find no such Congressional intent or expression to such an effect here." Caraway v. Ford Motor Co., 148 F. Supp. 776, 777 (W.D. Mo. 1957).

See also Southern States Oil Co. v. Standard Oil Co., 26 F. Supp. 633 (E.D.S.C. 1939); Boyd v. New York, N.H & H.R.R., 220 Fed. 174 (S.D.N.Y. 1915); cases cited in note 75 *supra*.

86 See RESTATEMENT, TORTS § 286 (1934); Lowndes, *Civil Liability Created by Criminal Legislation*, 16 MINN. L. REV. 361 (1932); Morris, *The Relation of Criminal Statutes to Tort Liability*, 46 HARV. L. REV. 453 (1933).

87 While there are analogies, there are also important distinctions between the effect of a statutory violation in a fiduciary action, on the one hand, and the effect of such a violation in an ordinary negligence suit, on the other. For example, in order that the negligence *per se* doctrine may be invoked the statute in question must have been a criminal one, and the plaintiff must have been within the class of persons it was designed to protect. RESTATEMENT, TORTS § 286 (1934). Such limitations do not apply when a statutory violation is offered in a fiduciary duty action as proof of a director's breach of his duty to the corporation. The similarities in the two actions are found, rather, in the fact that in each the statutory violation plays only an auxiliary or evidentiary role. Spirt v. Bechtel, 232 F.2d 241 (2d Cir. 1956), illustrates the results of failing properly to distinguish between the two situations. There the plaintiff stockholder lost his derivative fiduciary duty action because the court analyzed the case in terms of negligence *per se* and, finding the plaintiff not to be within the class sought to be protected by the statute in question, nonsuited him. That consideration would have been immaterial if the court

militates against exercise of the state court's power is that uniformity of interpretation of the federal antitrust laws will best be achieved by leaving their interpretation solely to the federal courts.[88] Counterbalanced against this consideration, however, is the fact that if the state refused to interpret the federal acts the plaintiff would have a clear state law right which the state court would be powerless to remedy. Thus although directors injured the corporation by federal antitrust law violations, the stockholders would be left totally remediless for losses from a prior adjudication under the antitrust laws and in all other cases where there were no grounds for showing breach of fiduciary duty other than in the violation of the statute.[89]

The policy question whether the state courts will exercise the power they have to interpret the federal antitrust laws, however, seems to be settled by a line of cases where state courts have regularly done so. It is established law that a state court will not enforce a contract which violates the federal antitrust laws.[90] In passing on this defense, a number of state courts have necessarily and expressly decided the question whether the contract before them did in fact violate the acts.

Another argument which might be urged is that the state court will use the federal antitrust laws as shield but not as a sword. The distinction is not meritorious. If it means that state courts will

had analyzed the case with reference to fiduciary duty principles. The same observations are applicable to Goldstein v. Groesbeck, 142 F.2d 422 (2d Cir. 1944), and Baird v. Franklin, 141 F.2d 238 (2d Cir. 1944).

88 This consideration was successfully urged, for example, with relation to § 14 of the Securities and Exchange Act of 1934, 48 Stat. 895 (1934), 15 U.S.C. § 78n (1958), in Investment Associates v. Standard Power & Light Corp., 29 Del. Ch. 225, 48 A.2d 501 (1946), *aff'd,* 29 Del. Ch. 593, 51 A.2d 572 (1947) (dictum).

89 The stockholders may still have an action against the directors under the antitrust laws, however, subject to the limitations noted in section II-A of this comment. It should also be noted that the threat of such a third-party antitrust action is not sufficient grounds for an injunction under the antitrust laws. Fein v. Sec. Banknote Co., 157 F. Supp. 146 (S.D.N.Y. 1957); Gomberg v. Midvale Co., 157 F. Supp. 132 (E.D. Pa. 1955).

90 Alpha Beta Food Markets, Inc. v. Amalgamated Meat Cutters, 147 Cal. App.2d 343, 305 P.2d 163 (1956); Schill v. Remington-Putnam Book Co., 182 Md. 153, 31 A.2d 467, *aff'd on rehearing,* 182 Md. 163, 32 A.2d 296 (1943); First Nat'l Bank v. Missouri Glass Co., 169 Mo. App. 374, 152 S.W. 378 (1912); General Aniline & Film Corp. v. Bayer Co., 305 N.Y. 479, 113 N.E.2d 844 (1953); Metropolitan Opera Co. v. Hammerstein, 221 N.Y. 507, 116 N.E. 1061 (1917), *affirming* 162 App. Div. 691, 147 N.Y.S. 532 (1914). *Cf.* A. B. Small Co. v. Lamborn & Co., 267 U.S. 248 (1925). *Contra,* General Talking Picture Corp. v. DeMarce, 203 Minn. 28, 279 N.W. 750 (1938). Of course, a defendant cannot get affirmative relief under the antitrust laws by way of counterclaim in a state action. Pennsylvania-Dixie Cement Corp. v. H. Wales Lines Co., 119 Conn. 603, 178 Atl. 659 (1935); Loew's, Inc. v. Don George, Inc., 237 La. 132, 110 So. 2d 553 (1959). See generally 5 WILLISTON, CONTRACTS §§ 1628-64 (1937); Lockhart, *Violation of the Antitrust Laws as a Defense in Civil Actions,* 31 MINN. L. REV. 507 (1947).

refuse to enforce the antitrust laws it is a mere truism.[91] If it means that a state court will ascertain the illegality of certain conduct under the federal antitrust laws as a substantive element of a defense in an action unrelated to those laws but not as substantive element of a cause of action which is equally unrelated to those laws, it is a distinction without a substantial basis. Uniformity of interpretation and exclusivity of remedies, the policy factors primarily applicable to this question which turns only on policy, are no more frustrated when the state court interprets the antitrust laws at the behest of the plaintiff than when it does so for the defendant.[92] The state courts have, therefore, the power to use the federal antitrust laws in the manner urged, as a matter of policy they should exercise this power, and in fact they do so in closely analogous contexts. The final question is whether federally-created illegality as well as illegality by reference to state law is of the quality which a state court will find to constitute a breach of fiduciary duty. The answer to this question is in the affirmative.[93]

4. *Simon v. Socony-Vacuum Oil Co.*[94] The *Simon* case implicitly affirms the above contentions. While the case unfortunately stands alone among state court authority it has never been overruled or criticized and, hence, would seem to represent good law.[95] The Socony-Vacuum Company and its directors were convicted of violating the Sherman Act.[96] As a result, great loss was suffered by the corporation in the form of fines, treble damages, and litigation expenses. Minority stockholders brought a derivative fiduciary suit in a New York court to hold directors liable to the corporation for such losses on the ground that they caused the corporation to violate the federal antitrust law in breach of their fiduciary duties. The defendants, in effect, conceded the illegality of their acts.[97] Thus the court was spared the necessity of deter-

[91] See cases cited in note 38 *supra*.

[92] Indeed, in one case a *plaintiff* sought a declaratory judgment that a contract was unenforceable on the ground that it violated the federal antitrust laws. Defendant demurred, contending that jurisdiction lay exclusively in the federal courts. The court held for plaintiff, construing the federal statutes in light of federal cases. Alpha Beta Food Markets v. Amalgamated Meat Cutters, 147 Cal. App.2d 343, 305 P.2d 163 (1956).

[93] See cases cited in note 75 *supra*.

[94] 179 Misc. 202, 38 N.Y.S.2d 270 (Sup. Ct. 1942), *aff'd mem.*, 267 App. Div. 890, 47 N.Y.S.2d 589 (1944).

[95] The effect of Spinella v. Heights Ice Corp., 186 Misc. 996, 62 N.Y.S.2d 263 (Sup. Ct. 1946), is hard to determine. The brief opinion cites with approval the *Simon* case but is too cryptic to shed much light.

[96] United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940).

[97] "That the defendant corporation participated in the unlawful buying program is not disputed. Nor is it questioned that the defendants, as directors, participated therein in

mining a violation. But since res judicata was not raised by the situation, the court, in entering jurisdiction, must have held that it had the power to adjudicate the fact of violation. The directors' conduct which was found illegal consisted of engaging in a buying program which very competent counsel[98] advised them was legal. Indeed, the majority of the Second Circuit[99] and even two members of the Supreme Court agreed.[100] The court, therefore, properly found for the defendants on the ground that the directors did not know their acts were illegal and could not, in the exercise of reasonable care, have known this. But the court by entertaining the fiduciary action based on a federal antitrust violation confirmed the holdings of the *Hand* and *Guiterman* cases that this type of action will lie in a state court.

D. *Policy Considerations*

The federal antitrust laws are extremely general. It is often difficult for an honest businessman acting with utmost good faith to stay within the laws, even with the aid of competent counsel.[101] While these considerations should not affect the legal question whether the fiduciary suit will lie, they should be carefully taken into account by a court entertaining such an action in deciding whether the directors or officers knew or should have known that their conduct violated the antitrust laws. The reasoning of the court in the *Simon* case is instructive in this regard:

> "It is elementary that directors owe a corporation the duty to exercise reasonable care in managing its affairs. . . .
>
> "At most [the facts show the directors] . . . made an honest and reasonable mistake or error of judgment or of law. . . .
>
> "But it is argued that defendants are liable because they committed acts prohibited by statute . . . even though they acted in good faith and with reasonable care. . . .

behalf of the corporation." Simon v. Socony-Vacuum Oil Co., 179 Misc. 202, 203, 38 N.Y.S.2d 270, 272 (Sup. Ct. 1942), *aff'd mem.*, 267 App. Div. 890, 47 N.Y.S.2d 589 (1944).

98 Failure to consult counsel may be evidence of negligence but is not conclusive. Litwin v. Allen, 25 N.Y.S.2d 667 (Sup. Ct. 1940).

99 United States v. Socony-Vacuum Oil Co., 105 F.2d 809 (7th Cir. 1939).

100 Justices Roberts and McReynolds, dissenting, felt the conduct complained of was legal under the Sherman Act. United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 254 (1940).

101 "[I]t must be confessed that there is no consistent or intelligible policy embodied in our law by which . . . business men may distinguish bona fide pursuit of industrial efficiency from an illicit program of industrial empire building." Jackson & Dumbauld, *Monopolies and the Courts*, 86 U. PA. L. REV. 231, 237 (1938).

> "The rule is too broadly stated. . . .
>
> "If the liability of a corporate officer is based on the . . . violation of a statute . . . the test of reasonable care . . . applies . . . [only] in so far as such care bears on whether he should have known that the acts in question were *ultra vires* or expressly forbidden. . . .
>
> "It seems to follow that, as the defendants . . . did not know or believe or have reason to believe that their participation in the buying program was prohibited by the Sherman Act, they cannot be held personally liable for damages."[102]

The staggering amount of the potential liability under statutes which provide for treble damages and fines and which involve great litigation expenses underscores the need for scrupulous attention to the issue of fault in the fiduciary suit. Personal liability should, therefore, be restricted to three types of situations: (1) Where the directors or officers *knowingly* violated the antitrust laws, (2) where they have acted in *bad faith,* and (3) absent scienter or bad faith, only where their acts constituted a *per se* violation of the antitrust laws.[103] Only in the latter case is the antitrust law clear enough to predicate liability on negligence in not having known that the given conduct was prohibited.

CONCLUSION

The *Fanchon & Marco* case has made it clear that a stockholders' derivative suit will lie under the antitrust laws to redress, by treble damages and injunctive relief, injury caused to the corporation by the anti-competitive effects of an antitrust violation. Various requirements of corporation law and antitrust law, however, limit the availability of such a suit to the case where at least one of the antitrust violators dominates the stockholders' corporation.

Where a corporation's management causes it to violate the federal antitrust laws and the corporation is forced to pay fines or

102 Simon v. Socony-Vacuum Oil Co., 179 Misc. 202, 203-05, 38 N.Y.S.2d 270, 273-74 (Sup. Ct. 1942), *aff'd mem.,* 267 App. Div. 890, 47 N.Y.S.2d 589 (1944). Two writers have assumed that proof of a violation of the antitrust statutes would *per se* constitute a breach of fiduciary duty. 5 STAN. L. REV. 480 (1953); 36 GEO. L.J. 441 (1948). This assumption overlooks the marked difference between these two concepts illustrated in the text in section II-A-1 and by the language quoted from the *Simon* case.

103 See REPORT OF THE ATTORNEY GENERAL'S NATIONAL COMMITTEE TO STUDY THE ANTITRUST LAWS 12 (1955).

damages and litigation expenses, a stockholders' derivative suit will lie to hold the directors personally liable to the corporation. Such an action lies not under the federal antitrust laws but rather upon the basis that causing such a violation is a breach of management's fiduciary duty to the corporation. Personal liability should be restricted, however, to cases where the individuals involved knew, or because of the *per se* nature of the violation should have known, that they were violating the law. The conviction of certain corporate officers in the recent electrical industry conspiracy cases is perhaps illustrative of this type of violation. When one considers the possible magnitude of the liability of such officers in a fiduciary duty action, the potential impact of the fiduciary duty action as it relates to the federal antitrust laws can readily be appreciated.

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