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CORPORATIONS - LIABILITY OF DIRECTORS FOR FAILURE TO ENFORCE CORPORATE RIGHT BY SECTION 16B OF SECURITIES EXCHANGE ACT

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CORPORATIONS — LIABILITY OF DIRECTORS FOR FAILURE TO ENFORCE CORPORATE RIGHT BY SECTION 16B OF SECURITIES EXCHANGE ACT—Plaintiff brought a stockholder's derivative suit against the directors of *X* corporation, alleging that they wilfully failed to demand short term profits made in the sale of the corporation's securities by an officer of the corporation. These profits were recoverable by the corporation pursuant to section 16B of the Securities Exchange Act of 1934.[1] Plaintiff further alleged that as a result of the directors' failure to sue, the statute of limitations barred recovery of these profits, giving rise to a common law action against the directors for waste. Defendants moved to dismiss. *Held*, motion granted. Directors were not liable for failure to bring suit on behalf of the corporation within the two year statutory period. *Truncale v. Universal Pictures Co.*, (D.C. N.Y. 1948) 76 F. Supp. 465.

Numerous cases reiterate that a director is a fiduciary[2] or an agent[3] charged with the duty of caring for the property of the corporation and managing its affairs honestly, diligently and in good faith.[4] Directors are liable for intentional departures from this duty; [5] and for negligent breaches,[6] such as an unreasonable failure to proceed against predecessors in office to recover losses sustained by the latter's mismanagement.[7] In the principal case, the court based its holding on dictum in a New York Supreme Court decision,[8] where it was stated that directors are not liable for failure to bring suit on behalf of the corporation within the statutory period. That decision actually held, however, that a derivative suit cannot be brought against directors for breach of duty to the corporation, when the statute of limitations bars the stockholder's action.[9] A later New York Supreme Court decision, overlooked by the court in the principal case, stated that there may be an action against directors who, not having participated in the original wrong,

[1] 15 U.S.C. (1946) 78p(b), provides for an action by the issuer or the owners of any security of the issuer against directors or officers to recover for the issuer any profits realized from a purchase and sale, or sale and purchase of the issuer's security by the directors or officers, within any period less than six months.

[2] Holcomb v. Forsyth, 216 Ala. 486, 113 S. 516 (1927). 19 C.J.S., Corporations, § 761.

[3] Mathews v. Fort Valley Cotton Mills, 179 Ga. 580, 176 S.E. 505 (1934). 3 FLETCHER, CYC. CORP., § 990 (1947).

[4] Clamitz v. Thatcher Mfg. Co., (C.C.A. 2d, 1947) 158 F. (2d) 687; Ashman v. Miller, (C.C.A. 6th, 1939) 101 F. (2d) 85; 19 C.J.S., Corporations, § 764.

[5] Green v. National Advertising and Amusement Co., 137 Minn. 65, 162 N.W. 1056 (1917).

[6] Wallach v. Billings, 277 Ill. 218, 115 N.E. 382 (1917).

[7] Harris v. Pearsall, 116 Misc. 366, 190 N.Y.S. 61 (1921).

[8] Druckerman v. Harford, (N.Y. S.Ct. 1940) 31 N.Y.S. (2d) 867. Cases cited as authority for the holding in the principal case also deal with stockholders' derivative suits against the directors and the limitations imposed on these suits by the six year and ten year statutes of limitations of New York. Potter v. Walker, 276 N.Y. 15, 11 N.E. (2d) 335 (1937); Goldstein v. Tri-Continental Corp., 282 N.Y. 21, 24 N.E. (2d) 728 (1939); Chance v. Guaranty Trust Co. of N.Y., 282 N.Y. 656, 26 N.E. (2d) 802 (1940).

[9] In the principal case, the three year statute of limitations, N.Y. Civil Practice Act (Cahill-Parsons, 1946) § 49 (7), governing common law actions for waste, had not run.

learn of it and improperly fail to take action within the statutory period.[10] It appears evident that directors violate their duty to the corporation by not collecting these short term profits, for the corporate assets would seem to be depleted by their failure to sue.[11] Nor is there any indication in the principal case that the directors could justify their actions by an honest and impartial belief that the best interests of the corporation would be served by refraining from bringing the suit.[12] The holding in the principal case does not seem to be consistent with the standard of conduct imposed upon directors in the management of corporate affairs by most courts today.[13]

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[10] American Cities Power & Light Corp. v. Williams, (N.Y. Co. S.Ct., Spec. Term 1947) 69 N.Y.S. (2d) 197. Justice Shientag decided both this case and Druckerman v. Harford, (N.Y. S.Ct. 1940) 31 N.Y.S. (2d) 867 (supra, note 8), which is the basis for the holding in the principal case. He does not refer to the Druckerman case in rendering his opinion in the later case.

[11] Carson, "Current Phases of Derivative Actions against Directors," 40 MICH. L. REV. 1125 at 1156 (1942).

[12] BALLANTINE, CORPORATIONS, rev. ed., § 147 (1946).

[13] 46 MICH. L. REV. 1061 at 1066 (1948).