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CORPORATIONS-OFFICERS AND DIRECTORS-FIDUCIARY DUTY OF OFFICER PURCHASING STOCK FROM SHAREHOLDER

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CORPORATIONS—OFFICERS AND DIRECTORS—FIDUCIARY DUTY OF OFFICER PURCHASING STOCK FROM SHAREHOLDER—Defendant, president of a corporation acquired stock owned by plaintiff and others by falsely representing that the corporation had been sold. After enhancing the value of this stock, defendant sold it. Plaintiff brought suit for fraudulent conversion and the trial court directed a verdict for the defendant. On appeal, *held,* reversed. An officer negotiating with a shareholder for the purchase of shares must act with scrupulous trust and confidence, and unless the officer acts with the utmost fairness the wronged shareholder may invoke the proper remedy. *Blazer v. Black,* (10th Cir. 1952) 196 F. (2d) 139.

The principal case presents a clear exposition of the minority rule first pronounced by the Georgia Supreme Court in 1903[1] on questionable authority.[2] The tempering of the harsh results which stem from the majority rule of caveat emptor[3] in situations with such glaring inequalities as are prevalent in transactions between directors or officers and shareholders[4] has long been favored by many leading scholars.[5] The trend is toward the intermediate or special facts view[6] which imposes a modified fiduciary duty of disclosure when there is an assured merger or sale of corporate assets and which also prevents active concealment.[7] This in effect is an application of the minority view in limited circumstances. However, it is doubtful whether it was necessary for the court in the principal case to base its decision on a fiduciary relation between the

[1] Oliver v. Oliver, 118 Ga. 362, 45 S.E. 232 (1903). The court reasoned that if the director were not a trustee for the individual shareholders, he could antagonize them one by one although he was bound to serve them en masse.

[2] The court based its decision on Jackson v. Ludeling, 21 Wall. (88 U.S.) 616 (1874), dealing with a questionable mortgage foreclosure which prejudiced the interests of bondholders, and on the following quotation from 2 POMEROY, EQUITY JURISPRUDENCE §1090 (1892): "Since the stockholders own these shares, and since the value thereof and all their rights connected therewith are affected by the conduct of the directors, a trust relation plainly exists between the stockholders and the directors, . . . from it arise the fiduciary duties of the directors towards the stockholders in dealings which may affect the stock and the rights of the stockholders therein. . . . To sum up, directors and managing officers . . . occupy a double position of partial trust; they are *quasi* or *sub modo* trustees for the corporation with respect to corporate property, and they are *quasi* or *sub modo* trustees for the stockholders with respect to their shares of the stock." Pomeroy cites twenty-two cases dealing with corporate waste and ultra vires acts in support of his proposition, none of which even remotely touches upon the problem of purchase of stock by a director from a shareholder.

[3] The rule of caveat emptor was applied in the following cases: Tippecanoe Co. v. Reynolds, 44 Ind. 509, 15 Am. Rep. 245 (1873); Hooker v. Midland Steel Co., 215 Ill. 444, 74 N.E. 445 (1905); Crowell v. Jackson, 53 N.J.L. 656, 23 A. 426 (1891); Walsh v. Goulden, 130 Mich. 531, 90 N.W. 406 (1902). See also, Dunnett v. Arn, (10th Cir. 1934) 71 F. (2d) 912 at 917, which clearly states the majority and the minority rules, and in which the court suggests that the majority rule be used for closely held corporations and the minority rule for large corporations where it is practically impossible for a shareholder to have full knowledge of corporate affairs. The suggestion, however, has not been carried out in the decisions.

[4] See for example, Oliver v. Oliver, 118 Ga. 362, 45 S.E. 232 (1903), cited in note 1 supra.

[5] 2 POMEROY, EQUITY JURISPRUDENCE §1090 (1892); 3 FLETCHER, CYC. CORP. §1168.2 (1947); BALLANTINE, CORPORATIONS §80 (1946); Laylin, "The Duty of a Director Purchasing Shares of Stock," 32 YALE L.J. 637 (1923); Wilgus, "Purchase of Shares of a Corporation by a Director from a Shareholder," 8 MICH. L. REV. 267 (1910); Berle, "Publicity of Accounts and Director's Purchases of Stock," 25 MICH. L. REV. 827 (1927).

[6] See annotation of cases in 84 A.L.R. 615 at 623 (1933) and 3 FLETCHER, CYC. CORP. §1168.1 (1947). See also, Zahn v. Transamerica Corp., (3d Cir. 1947) 162 F. (2d) 36 and Speed v. Transamerica Corp., (D.C. Del. 1951) 99 F. Supp. 808, which impose a fiduciary duty of disclosure upon majority shareholders in dealings with minority shareholders. The Transamerica cases are an extension of the minority rule which was formerly limited to directors and managing officers.

[7] 3 FLETCHER, CYC. CORP. §1171 (1947).

officer and the shareholder. By his misrepresentations as to the sale of the corporation, the officer committed an active fraud which opens the transaction to attack in all jurisdictions in an action for deceit or for recission and accounting.[8]

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[8] The following cases hold directors liable in a common law action for deceit: Von Au v. Magenheimer, 196 N.Y. 510, 89 N.E. 1114 (1909); Fisher v. Budlong, 10 R.I. 525 (1873); Prewitt v. Trimble, 92 Ky. 176, 17 S.W. 356 (1891); Smith v. Moore, (9th Cir. 1912) 199 F. 689; Buckley v. Buckley, 230 Mich. 504, 202 N.W. 955 (1925). See also: 12 FLETCHER, CYC. CORP. §§5580, 5581 (1932); 2 THOMPSON, CORPORATIONS §1363 (1927); de Funiak, "Fraud or Misrepresentation by Purchaser Inducing Sale of Shares of Stock," 26 Ky. L.J. 285 (1938); 46 YALE L.J. 143 at 146 (1936); 50 MICH. L. REV. 743 (1952).