

February 1932

Corporations--Disability of Corporation to Act as Affecting Fiduciary Duty of Director to Stockholder

John Hampton Hoge
West Virginia University College of Law

Follow this and additional works at: <https://researchrepository.wvu.edu/wvlr>



Part of the [Business Organizations Law Commons](#)

Recommended Citation

John H. Hoge, *Corporations--Disability of Corporation to Act as Affecting Fiduciary Duty of Director to Stockholder*, 38 W. Va. L. Rev. (1932).

Available at: <https://researchrepository.wvu.edu/wvlr/vol38/iss2/8>

This Student Note is brought to you for free and open access by the WVU College of Law at The Research Repository @ WVU. It has been accepted for inclusion in West Virginia Law Review by an authorized editor of The Research Repository @ WVU. For more information, please contact ian.harmon@mail.wvu.edu.

The court, receding from the position to which past decisions might logically impel it, draws an arbitrary line in applying the separation of powers doctrine strictly to a matter of state-wide interest. It cites in bold relief a United States Supreme Court decision of 1880 extolling this doctrine.⁵² Time has disproved earlier fears. Aside from the growth of commissions, the instances have been comparatively few in which the legislature has sought to burden greatly other branches of government. The proper function of this doctrine is not to establish a system of checks and balances.⁵³ More recent decisions treat it as a testing instrument of the reasonableness of the legislature's administrative scheme under the differing circumstances of cases and times.⁵⁴ If the water power act is unconstitutional, it is because the administrative features are unreasonable and not because of an invalid delegation of power. The legislature has declared its policy as to water power development, and its wisdom in such matters should not be judicially questioned. If the power to regulate exists, the fact that the legislature has created additional safeguards by executive supervision and judicial review, should not invalidate the act because of Montesquian conceptions of the division of power.

—BERNARD SLOVE.

CORPORATIONS — DISABILITY OF CORPORATION TO ACT AS AFFECTING FIDUCIARY DUTY OF DIRECTOR TO STOCKHOLDER. — The Columbia Oil Company (hereafter called the Columbia) is a corporation whose principal office is at Sistersville, West Virginia. It was successful and had properties in a number of states. A decision was made (which was probably well known to all stockholders) to enter the Wyoming field, and the Big Horn Oil & Gas

powers of Federal courts in the several states, but with such authority as a State may confer on her courts".

⁵² Kilbourn v. Thompson, 103 U. S. 168, 26 L. Ed. 377 (1880). But Laski, *Authority in the Modern State* (1919) 70, 71, writes: "The one obvious method by which the past sought refuge from the dangers of authority has proved in fact elusive (referring to this doctrine). It is in fact a paper merit for the simple reason that in practice it is largely unworkable. The business of government does not admit any exact division into categories".

⁵³ See Green, *The Separation of Governmental Powers* (1920) 2 ILL. L. BULL. 373-416.

⁵⁴ "In determining what it (one branch of government) may do in seeking assistance from other branches, the extent and character of that assistance must be fixed according to common sense and the inherent necessities of the governmental coordination," per Taft, C. J., *Hampton and Co. v. U. S.*, 276 U. S. 394, 406, 48 S. Ct. 348, 351 (1928).

Company (hereafter called the Big Horn) was organized for that purpose, seven-eighths of the stock being held in trust for the Columbia. The Big Horn was supplying two Wyoming towns with gas but the supply began to fail, so efforts were made to have the government release lands so that exploration could be made for new supplies. Thereupon eight persons, the majority being directors of the Columbia, applied for patents on three 160 acre tracts of land for the benefit of the Big Horn. It was then discovered that the government would refuse such patents because the Big Horn as one person under the law was entitled to enter on 20 acres only, so the entries for its benefit were illegal. Confronted with this difficulty a hurried meeting of such directors as could be found was held and it was resolved that the directors should take land in their own rights. Pursuant thereto entries were made on two 160 acre tracts by eight persons, most of whom were directors of the Columbia, the eight forming a partnership called the Greybull Oil Company. Oil was discovered on these two tracts to which patents were duly issued, but since gas was desired entry was made on a third 160 acre tract where gas was discovered and turned into the Big Horn lines. A new corporation was then organized which took over the property of the Big Horn and also these claims of the Greybull Company and for the latter the eight partners got preferred stock which they sold at a handsome profit. These acts of the Greybull Partners were approved at a stockholders meeting by the majority shareholders. The minority shareholders sued five of the eight partners of the Greybull Company, the five being directors of the Columbia, claiming the right to share in the profits of such partners. The bill alleged that the three tracts patented by the Greybull partners were the same three tracts which had formerly been applied for in trust for the Big Horn and that the defendants had then taken patents in their own rights and made large profits and had violated a fiduciary relation to the complainants, hence should not be permitted to retain such profits. Whether the three tracts were the same does not appear in the opinion of the court. It seems however that the solvency of the Big Horn was doubtful; that the defendants could not secure patents for the benefit of the corporation for that would be illegal. Therefore the defendants violated no fiduciary duty to either the Big Horn or to the Columbia, so that there was no right to recover the profits made in behalf of either corporation, but had it not been for the inability to take patents for one of the corporations the defendants would

have been liable for the profits realized, not to the shareholders but to the corporation directly and suit could have been brought only in behalf of the corporation.¹ The court held that there was a fiduciary duty to the stockholders of the Columbia which the defendants had violated as to some of them.² As nearly as can be determined the duty was to notify all shareholders of the Columbia of the situation and of the application for patents by defendants as individuals and on such notice each stockholder had the right to make timely notification of his intent to participate in the venture, but those who did have notice and did not indicate intent to participate in the venture lost their rights by laches since each one must assume the risk of loss as well as the chance of profits. It was held that three stockholders did not have timely notice and could recover in the proportion their stock bore to the total outstanding stock of the Columbia, and that certain others did have notice and were barred from recovery by their laches. It seems therefore that the decision is to the effect that if directors in the conduct of corporate business discover a desirable opportunity for investment and profits which they cannot take advantage of on behalf of the corporation because it would be beyond the corporate powers, they will not be permitted to take advantage of it for themselves but must give notice of the opportunity to all the stockholders so each stockholder may decide whether or not to participate in the venture and that each stockholder does have the privilege of joining in the joint adventure and taking the risk of losses and the benefit of any profits that may be realized; that the relation of director and stockholder is to this extent fiduciary.

No authorities going this far have been discovered. There is one class of cases where some courts have held there is a fiduciary relation between director and stockholder, namely where the director has information concerning corporate affairs which will enhance the value of the stock and buys stock directly from the stockholder. Here it is perhaps clear that if the stockholder inquires and the director gives any information he is under duty to make a full revelation.³ But otherwise, many courts hold

¹ *Smith v. Hurd*, 12 Metc. (Mass.) 371, 46 Am. Rep. 690 (1847); *Allen v. Curtis*, 26 Conn. 456 (1857); *Deaderick v. Wilson*, 67 Tenn. 87 (1874). See POMEROY, *EQUITY JURISPRUDENCE* (4th ed. 1919) § 1090.

² *Young v. Columbia Oil Co.*, 158 S. E. 678 (W. Va. 1930).

³ *Poole v. Camden*, 79 W. Va. 310, 92 S. E. 454 (1917).

⁴ *Carpenter v. Danford*, 52 Barb. (N. Y.) 581 (1868); *Board of Commissioners v. Reynolds*, 44 Ind. 509, 15 Am. Rep. 245 (1873); *Crowell v. Jackson*, 53 N. J. L. 656 (1891).

the director may buy stock of the stockholder and is not under duty to volunteer information, because the stock is the private property of the stockholders over which the director has no control and in dealing with it the situation of the parties is the same as if they were strangers.⁴ Other courts make an exception where there are "special facts" which raise the duty of disclosure as in the case of *Strong v. Repide*.⁵ Still other courts more recently hold there is a duty to disclose facts tending to enhance the value of the stock, on the view that a share of stock in itself is nothing but a mere scrap of paper and the real property is the corporate assets managed by the directors for the stockholders as the real parties in interest.⁶ But in these cases the director is taking something of potential value from the stockholder, while in the case of the disability of the corporation to act and directors act individually the stockholders are merely deprived of an opportunity to enter upon a business venture. This case then goes a step further than previous decisions.

In determining whether there is a fiduciary duty from the director to the stockholder when the corporation is under a disability, it should be remembered that this so-called fiduciary relationship is not a fiduciary relationship in the strict sense of the term, but is a mere means of equity acting upon the confidential relationship between the parties so as to effectuate justice. In view of this, it would seem desirable not to give too much weight to the idea of the corporate entity and recognize that after all the directors are acting for the stockholders, who are the real parties in interest. When there has been a breach of duty to the corporation the suit should be in the name of the corporation, because that is the form in which the parties are doing business, but when the only reason that the corporation cannot act or sue is illegality or lack of power to act in the corporate form, the director should in fairness to the stockholders make timely disclosure of the true situation to them and permit them to do whatever is necessary to protect their interests.

It has been contended that in the sale of stock case no fiduciary relationship should be held to exist between the director and

⁴213 U. S. 419, 29 S. Ct. 521 (1909). In that case the court relied upon the fact that stock was bought by a secret agent, and also upon the fact that the purchaser owned a very large majority of the stock and the stockholders recognized him as a sort of agent for the stockholders in affairs concerning the corporation.

⁵*Oliver v. Oliver*, 118 Ga. 362, 45 S. E. 232 (1903); *Stewart v. Harris*, 69 Kan. 498, 77. Pac. 277 (1904); *Steinfeld v. Nielson*, 12 Ariz. 381, 100 Pac. 1094 (1904).

the shareholder, when the sale is on the open market, because the parties deal solely with reference to the market value and as mere strangers without any knowledge of or regard for the relation of director and stockholder. A stronger ground for such an exception would be the impracticability of notice in such case.⁷ Likewise, in the case of corporate disability to act, the impracticability of giving notice, or the need for immediate or secret action to make the business undertaking a success might cause an exception to the rule, but in the ordinary case give the shareholders the privilege of carrying out the undertaking in some other form, if they are under a disability to act as a corporation.

—JOHN HAMPTON HOGE.

SPECIFIC PERFORMANCE — MUTUALITY DOCTRINE IN WEST VIRGINIA. — “A contract to be specifically enforced by the court must be mutual—that is to say such that it might, at the time it was entered into, have been enforced by either of the parties against the other of them.”⁸

Attempts to apply the doctrine of mutuality as thus laid down by Fry have led to much confusion. Often while one court was quoting it to prove that a certain type of contract could not be enforced specifically, another would be citing it as grounds for

⁷ Walker, *The Duty of Disclosure by a Director Purchasing Stock from His Stockholders* (1923) 32 YALE L. J. 637; BALLANTINE, *PRIVATE CORPORATIONS* (1927) 398.

⁸ FRY, *SPECIFIC PERFORMANCE OF CONTRACTS* (3d ed 1884) § 440. Compare POMEROY, *SPECIFIC PERFORMANCE OF CONTRACTS* (1897) § 165, “If the remedy of specific performance of a contract exists at all, it must be mutual; the remedy must be attainable alike by both parties to the agreement.” See the same author eight years later in 6 POMEROY’S *EQUITY JURISPRUDENCE* (3d ed. 1905) § 769, where he says, “It is a mutuality of remedy in equity at the time of filing the bill that is required.” Then see the fourth edition of the same work, vol. 5, § 769, where Mr. Pomeroy says, “The court will not grant specific performance to the plaintiff and at the same time leave defendant to the legal remedy for possible future breaches on plaintiff’s side.” For language to the same effect, see Ames, *Mutuality in Specific Performance* (1903) 3 COL. L. REV. 1, 2. Professor Ames, however, continues, “The reciprocity of remedy required is not the right of each party to the contract to maintain a bill for specific performance against the other, but simply the right of one party to refuse to perform, unless performance by the other is given or assured.” For an excellent article on the present status of the mutuality doctrine, see Cook, *The Present Status of the “Lack of Mutuality” Rule* (1927) in 36 YALE L. J. 897. Mr. Cook concludes that about all that seems to be required is that the other party will probably continue to perform and that no serious injustice will be done.