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Corporations -- Director's Right to Enforce Bonds Purchased at Discount During Insolvency of Bankrupt Corporation

equity has jurisdiction of an ancillary bill, dependent upon the jurisdiction of the original suit and the decree,[36] even though the grounds of federal jurisdiction of an original suit are lacking.[37] Thus, an ancillary bill may be brought without a consent of the sovereign to suit other than the consent to the original suit;[38] and a waiver of the immunity, by an official authorized to do so, extends to an ancillary suit.[39] However, the ancillary bill must be within the terms of the statutory consent; so if the ancillary proceeding is not a procedural continuation of the original suit, then the consent does not allow the ancillary suit.[40] And in order for the appearance by an authorized state official to constitute a waiver extending to an ancillary proceeding, the State must have been party to the original adjudication.[41] The instant case, then, lays down the rule that the official must be authorized to waive the immunity, for his appearance to constitute a valid waiver of the immunity respecting an ancillary suit to enforce the prior decree.[42]

Inasmuch as there is a dearth of authority concerning the use of an ancillary bill to enforce the decree in a suit against the state, there appears to be no reason for questioning the correctness of the ruling that the state official must have authority to waive the immunity for the state. However, the more noteworthy feature of the instant case is the reasoning by which the court found that the Attorney General lacked the authority to waive the immunity from suit. The extension of the 'clear intention' doctrine from cases concerning statutory consent is in accord with the lack of distinction by the courts between such consent and waiver of the immunity by an official. But the requirement that the legislative provision giving the authority should be directly related to the subject-matter, unduly prescribes the mode in which the legislature may exercise its discretion to indicate the intention of the state to be suable in a federal court.

CORPORATIONS—DIRECTOR'S RIGHT TO ENFORCE BONDS PURCHASED AT DISCOUNT DURING INSOLVENCY OF BANKRUPT CORPORATION

Respondents, the wife, mother, and friend of directors of the debtor corporation, purchased its debenture bonds at a large discount during a

36. Cincinnati, I. & W. R.R. v. Indianapolis Union Ry., *supra;* Hoffman v. McClelland, 264 U.S. 552 (1924); Krippendorf v. Hyde, 110 U.S. 276 (1884).

37. Root v. Woolworth, 150 U.S. 401 (1893); Julian v. Central Trust Co., 193 U.S. 93 (1904); Riverdale Cotton Mills v. Alabama and Georgia Mfg. Co., 198 U.S. 188 (1905); Gunter v. Atlantic Coast Line R.R., *supra.*

38. Becker Steel Co. of America v. Cummings, *supra;* Gunter v. Atlantic Coast Line R.R., *supra.*

39. Gunter v. Atlantic Coast Line R.R., *supra;* see Great Northern Life Ins. Co. v. Read, *supra;* Ford Motor Co. v. Dep't of Treasury, *supra.*

40. Becker Steel Co. of America v. Cummings, *supra.*

41. Missouri v. Fiske, *supra.*

42. See note 24, *supra.*

period when debtor was technically [1] insolvent. All the bonds were acquired prior to any liquidation proceedings and while the debtor, though operating as a deficit, was a going concern. The respondents, who purchased the bonds at between 3 percent and 14 percent of face value, now claim a 46 percent share at liquidation.[2] Petitioner, as trustee [3] and individually as creditor, filed objection to the allowance of respondent's claims on the ground that the circumstances under which the bonds were acquired made it equitable to limit the claim to the actual purchase price. *Held,* on certiorari, affirming judgment of the circuit court,[4] that the claimants[5] were entitled to share on a par with the other bondholders. The transactions were in good faith and in the course of fair dealing; the probability of an actual conflict, between the director's self-interest and his duties to the corporation, was not great enough to require that equity declare ended the opportunity for profitable trading. *Manufacturers Trust Co. v. Becker,* 70 Sup. Ct. 127 (1949).

In a broad sense, the directors and officers of a corporation are to be considered as its agents,[6] occupying a quasi-fiduciary relation to the corporation;[7] and it is well settled that neither bargaining with the company at "arms length" nor sharp dealing under a claim of the privilege of *caveat emptor* is permissible.[8] Without the fullest disclosure to and assent of all parties concerned, directors are precluded from making a private profit from their official position, since they impliedly undertake to exercise the powers conferred upon them solely in the interests of the corporation.[9]

The fiduciary duty of a director, however, is not identical with that of all other fiduciaries,[10] and the courts should not categorically impose upon

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1. The debtor corporation was insolvent in the bankruptcy or balance sheet sense; i.e., there was an excess in the amount of liabilities over the total value of the assets, as distinguished from equitable insolvency where there is an inability to meet debts and obligations as they fall due. See BALLANTINE, CORPORATIONS § 248 (2d ed. 1946).

2. This case arose in a proceeding for arrangement filed by the debtor under provisions of Chapter XI of the Bankruptcy Act, 30 STAT. 949 (1898), as amended, 52 STAT. 905 (1938), 11 U.S.C. § 701 (1946).

3. The appellant is trustee under the indenture pursuant to which the debenture bonds were issued in 1933.

4. *In re* Calton Crescent, Inc., 173 F.2d 944 (2d Cir. 1949), *aff'd sub nom.* Manufacturers Trust Co. v. Becker, 70 Sup. Ct. 127 (1949).

5. The claimants, close relatives of the directors of the debtor, were considered as directors or in a like position; the court's decision, of course, makes it unnecessary to determine whether the relation of the claimants to the directors was actually such as to place them under the limitations applicable in the case of directors.

6. Louisville, N.A. & Co. Ry. v. Louisville Trust Co., 174 U.S. 552 (1899); Manson v. Curtis, 223 N.Y. 313, 119 N.E. 559 (1918).

7. *See* Twin-Lick Oil Co. v. Marbury, 91 U.S. 587 (1875); Jackson v. Ludeling, 21 Wall. 616 (U.S. 1874); Orlando Orange Groves v. Hale, 107 Fla. 304, 144 So. 674 (1932); Beach v. Williamson, 78 Fla. 611, 83 So. 860 (1919); RESTATEMENT, AGENCY § 14 (1933).

8. Wendt v. Fischer, 243 N.Y. 439, 154 N.E. 303 (1926); *see* Meinhard v. Salmon, 249 N.Y. 458, 464, 164 N.E. 545, 546 (1928).

9. McGourkey v. Toledo & O.C. Ry., 146 U.S. 536 (1892); Thomas v. Brownville Ft. K. & P. R.R., 109 U.S. 522 (1883); Twin-Lick Oil Co. v. Marbury, *supra;* Jackson v. Ludeling, *supra;* Tampa Water Works Co. v. Wood, 97 Fla. 493, 121 So. 789 (1929).

10. For an excellent discussion on the various standards of trustees, agents,

them the same strict disabilities[11] thereby precluding all dealings by a director with his corporation merely by reason of his official position. While aware that there is normally present a great danger that a director, in the face of a conflict of interests, will act to benefit himself at the expense of the corporation or its creditors,[12] the courts have recognized that they should not stamp as fraudulent every transaction in which a director has an interest.[13] Consequently it is generally accepted that, where under the closest scrutiny of the court,[14] such transactions are found to be characterized by absolute good faith and fairness, they are not to be invalid per se but will be upheld, especially when clearly of benefit to the enterprise.[15]

This good faith standard has been applied to allow a director to purchase additional shares in his company,[16] since the result is an added incentive to him to make the corporation succeed;[17] and on this same reasoning the courts have also permitted the director to purchase outstanding obligations of a solvent and going concern, even at a discount, with the right to enforce them against the company in their full amount.[18] It is important to note that the possibility of a conflict of interests arising becomes greater as the corporation becomes less of a going concern; the more precarious the financial position—the more it approaches liquidation, manifestly the more it needs the undivided loyalty of its directors. Clearly, where the debtor is insolvent and liquidation proceedings have begun or are expected, the director is not permitted to purchase outstanding obligations at a discount and then enforce them at full value,[19] for any incentive he may gain is negligible since he has little control over the success of the liquidation now in the hands of the court.[20]

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guardians, partners, executors, corporate directors and promoters, etc., see Scott, *The Trustee's Duty of Loyalty*, 49 HARV. L. REV. 521 (1936).

11. See BALLANTINE, CORPORATIONS § 66 (2d ed. 1946).

12. This has been so in a multitude of cases arising from (1) contracts of purchase or sale of goods, services, realty, etc., by the corporation; (2) loans to and by the corporation; (3) purchase and sale of stocks and bonds or other claims; and in these many factual and legal possibilities above, whether the corporation is dealing directly or indirectly (through third persons) with the interested directors. See Dodd, *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932); Berle, *For Whom Corporate Managers* are *Trustees: A Note*, 45 HARV. L. REV. 1365 (1932).

13. See notes 10 and 11, *supra;* Dodd, *Is Enforcement of Fiduciary Duties of Corporate Managers Practicable?*, 2 U. OF CHI. L. REV. 194 (1935).

14. *See* Pepper v. Litton, 308 U.S. 295, 308-309 (1939); Stuart v. Larson, 298 Fed. 223 (8th Cir. 1924); Miner v. Belle Isle Ice Co., 93 Mich. 97, 53 N.W. 218 (1892).

15. Richardson v. Green, 133 U.S. 30 (1890); Stuart v. Larson, *supra;* Orlando Orange Groves Co. v. Hale, *supra.*

16. S.E.C. v. Chenery Corp., 318 U.S. 80 (1943).

17. Although such a transaction certainly gives rise to personal interests of the director, it does not necessarily follow that those interests must conflict with his duties to the corporation and its creditors; moreover, in many cases both may benefit.

18. Seymour v. Spring Forest Cemetery Ass'n, 144 N.Y. 333, 39 N.E. 365 (1895).

19. Monroe v. Scofield, 135 F.2d 725 (10th Cir. 1943); *In re* Norcor Mfg. Co., 109 F.2d 407 (7th Cir. 1940); *In re* Philadelphia & Western Ry., 64 F. Supp. 738 (E.D. Pa. 1946); *In re* Jersey Materials Co., 50 F. Supp. 428 (D.N.J. 1943); *In re* Los Angeles Lumber Products Co., 46 F. Supp. 77 (S.D. Cal. 1941).

20. See Hand, J., dissenting in *In re* Calton Crescent, 173 F.2d 944, 952 (2d Cir. 1949).

In the present case, the corporation was neither a solvent and going concern, nor insolvent and in bankruptcy. This poses the problem of determining whether and to what extent a conflict arises in such a "twilight zone" where the debtor's directors purchase unmatured bonds at a discount. It has been pointed out that, with certain well founded exceptions,[21] there is no valid reason to apply the insolvency restriction doctrine to the case of an insolvent *but going* concern;[22] cases have so held, assigning greater importance to the corporation's vitality than to its balance sheet insolvency.[23] Consequently, as indicated by the Court in the instant case,[24] where there is present a possibility of effecting a composition and solvency, purchase by a director of the corporation's debts, even when at a great discount, may definitely offer both an added incentive to the director and a benefit to the enterprise.[25] But on the other hand, this possibility should not foreclose a most serious consideration of the dangers arising from such purchases by directors whose access to confidential corporate information emphasizes the good faith demanded of them, especially where the corporation is in the hands of a small number of directors.

In conclusion, where there is present, as in the noted case, evidence of financial instability of the corporation, perhaps the most satisfactory determination of an actual conflict of loyalties would be made by placing upon the director, as in most cases of dealings between a director and his corporation,[26] the burden of showing absolute good faith and fair dealing. Specifically, it is submitted that there should be a finding, absent in the instant case, of whether or not, at the time of the purchase of the bonds in question, there was

21. These exceptions relate to cases (1) where a special fund has been provided by the debtor corporation to pay the obligation; (2) where a special liquidation has been ordered through the institution of receivership or kindred proceedings; (3) where the debtor was in the field to settle its own obligations; (4) where the acquisition of the obligation by the director was unfair to the debtor and involved competition with it; and (5) where the director is guilty of overreaching, by unfairly using his special knowledge, in dealing with those from whom he acquired the obligations. [Brief of Respondent, p. 76.]

22. During insolvency the corporation more than ever needs such loans; (1) it may be possible to forestall bankruptcy while the corporation composes itself, and (2) the credit of the company may be improved if it is known that directors are purchasing the corporation's securities. See 62 HARV. L.REV. 1391, 1392 (1949).

23. Sanford Fork & Tool Co. v. Howe, Brown & Co., 157 U.S. 312 (1895); White, Potter & Paige Mfg. Co. v. Henry B. Pettes Importing Co., 30 Fed. 864 (C.C.E.D. Mo. 1887).

24. 70 Sup. Ct. 127, 132 (1949); the Court stated that "In any event, the potentiality of conflict must be weighed against the desirability of permitting reinforcement of the insolvent's position insofar as a director's acquisition of claims may help."

25. In the principal case, the directors, who purchased the bonds at 3% to 14%, were able to forestall bankruptcy until they could sell the assets at a price which gave the bondholders 46% of face value.

26. Pepper v. Litton, *supra* at 306 (all dealings); Sanford Fork & Tool Co. v. Howe, Brown & Co., *supra;* American Exch. Nat. Bank v. Ward, 111 Fed. 782 (8th Cir. 1901) (officers prefer themselvees as creditors); *accord,* Corsicana National Bank v. Johnson, 251 U.S. 68 (interlocking directors); McCaffrey v. Elliott, 47 F.2d 72 (5th Cir. 1931) (purchase of corporate property by director); Drennen v. Southern States Fire Ins. Co., 252 Fed. 776 (5th Cir. 1918) (sale of property to corporation by directors).

sufficient prospect of liquidation to bring the interests of the directors into conflict with those of the corporation and its creditors. Directors, then, occupying a position which puts it within their power to conceal the evidence of the facts and to defy detection, should be given the burden of showing that, at the time of their purchase, there was a well founded expectation of the debtor's composition and solvency.

CRIMINAL PROCEDURE—EVIDENCE—PRIVILEGE OF JUROR ON CROSS EXAMINATION

Defendant was indicted for entering into a conspiracy or agreement that he would vote falsely while doing jury duty.[1] On direct examination of another juror, testimony was admitted as to how defendant-juror had voted in the jury room. Cross examination as to how other jurors had voted was declared improper because of the juror privilege. On appeal, *held,* that there was no error in restricting the cross examination. *Burton v. United States,* 175 F.2d 960, *rehearing denied,* 176 F.2d 865 (9th Cir. 1949).

It is a general rule that communications among jurors are privileged against disclosure on the witness stand without their consent.[2] The privilege is based on the public policy that by assurance of secrecy in the jury room there will be promoted freedom of discussion and deliberation so essential for a proper determination by the jurors.[3] However, there are exceptions to this privilege. It does not apply where the relation in which it arose has been fraudulently commenced or continued,[4] nor where a juror has been guilty of misconduct with respect to some collateral matter.[5]

Sometimes the rule is confused with the competency of the witness to testify in the impeachment of a verdict.[6] Where the situation involves the impeachment of a verdict, the courts generally have kept the juror's privilege inviolate.[7] On the other hand, where the suit in which the juror had served ended in a mistrial, the privilege as to impeachment of a verdict was held inappropriate and testimony by other jurors as to the defendant-juror's statements was admitted.[8] This represents a sharp divergence from privileges for confidential communications where testimony is excluded, except when waived or offered voluntarily by the person asserting the privilege.[9] An *extension* allowed

1. 35 STAT. 1096 (1909), 18 U.S.C. § 88 (1946).
2. 8 WIGMORE, EVIDENCE § 2346 (3d ed. 1940).
3. M'Kain v. Love, 2 Hill 506 (S.C. 1834).
4. Clark v. United States, 289 U.S. 1 (1932), 81 U. OF PA. L. REV. 1000 (1933).
5. *In re* Cochran, 237 N.Y. 336, 143 N.E. 212 (1924) (An attempt to corrupt vote).
6. See Clark v. United States, *supra* at 12, 13.
7. Hyde v. United States, 225 U.S. 347 (1911); Kelly v. State, 39 Fla. 122, 22 So. 303 (1897). *See* McDonald v. Pless, 238 U.S. 268, 269 (1914). See 8 WIGMORE, EVIDENCE § 2354 n.1 (3d ed. 1940) (at least one exception to this in a dozen code states).
8. Clark v. United States, *supra.*
9. 8 WIGMORE, EVIDENCE § 2354 (3d ed. 1940).