

DEPARTMENT OF CORPORATIONS.

EDITOR-IN-CHIEF,

ANGELO T. FREEDLEY, ESQ.,

Assisted by

LEWIS LAWRENCE SMITH,

MAURICE G. BELKNAP,

CLINTON ROGERS WOODRUFF,

H. B. SCHERMERHORN.

ELLERMAN *v.* CHICAGO JUNCTION RAILWAYS AND UNION
STOCKYARDS CO. ET AL.¹ NEW JERSEY
COURT OF CHANCERY.

*Directors' Discretion in Corporate Acts—Right of Stockholder to
Question.*

Where a bill was brought against the Chicago Junction Railways and Union Stockyards Company by the stockholders of the same, to enjoin the company from carrying into effect a certain agreement deemed by the stockholders to be beyond the authority of the directors thereof, *held*, that individual stockholders could not question, in judicial proceedings, the corporate acts of directors, if the same are within the powers of the corporation, and in furtherance of its purposes, are not unlawful or against good morals, and are done in good faith and in the exercise of an honest judgment.

Decided December 18, 1892.

THE RIGHT OF STOCKHOLDERS TO CONTROL THE DISCRETION OF
DIRECTORS IN CORPORATE ACTS.

As a general rule the courts will presume that contracts entered into by a corporation, which appear to be designed to promote its legitimate and profitable operation, are within the limits of its powers, and if their validity be assailed, will require the assailant to assume the burden of demonstrating that fact.

Questions of policy, of management, of expediency, of contracts or action, of adequacy of consideration not grossly disproportionate, of lawful appropriation of corporate funds to advance corporate interests—are left solely to the honest decision of the directors, if

their powers are without limitation and free from restraint. Any other view would substitute the judgment and discretion of others in the place of those determined on in the formation of the corporation: *Park v. Grant Locomotive Works*, 40 N. J. Eq., 114; 10 Am. & Eng. Corp. Cas., affirmed, 45 N. J. Eq., 244; *Elkins v. Camden & A. R. R. Co.*, 36 N. J. Eq., 241; 11 Am. & Eng. R. R. Cas., 579; *Rutland & B. R. Co. v. Proctor*, 29 Vt., 93; *Mor. Priv. Corp.*, § 243; *Beach, Corp.*, p. 388.

In his opinion in the case of *Ellerman v. Chicago J. R. & U. S.*

¹ Reported in 49 N. J. Eq., 217.

Co., GREEN, V. C., says: "The question of adequacy of the consideration received by the company for what it agreed to pay is one which is not open to the plaintiff. So long as the consideration was valuable, and not so inadequate as to impute fraud, the amount to be paid was in the discretion of the board of directors, and will not be inquired into by the court. . . . The terms of the contract and the consideration having, then, been settled by the directors, on what ground is it attacked? There is no intimation of fraud. No improvidence is alleged; no extravagance; no absence of occasion moving such a contract; no allegation of haste or of mistake of facts. Nothing is alleged but error of law on the part of the directors who unanimously approved the agreement."

Chancellor GREEN then goes on to show that the legal presumption is in favor of the agreement, and that the burden lies upon the complainant to demonstrate that the agreement was beyond the corporate powers, and to show how and where the legal restraint arises or was imposed which rendered the contract *ultra vires*. See Wood on Railway Law, p. 526; also Shrewsbury, etc. R. Co. v. Northwestern R. Co., H. L. Cas., 113.

After a further examination into the nature of the proposed agreement, and into the powers with which the corporation was invested by its charter, Chancellor GREEN concludes: "In my opinion the covenants entered into by the company in this contract are referable to the objects stated in their certificate of corporation, or to powers incident to the corporation, and are authorized by its charter. . . .

And I advise that the bill be dismissed with costs."

In such cases the court will not interfere unless, as JAMES, L. J., said, in *Macdougall v. Gardiner*, L. R., 1 Ch. Div., 13, "there be something illegal, oppressive, or fraudulent—unless there is something *ultra vires* on the part of the company *quâ* company, or on the part of the majority of the company, so that they are not fit persons to determine it." In *Dodge v. Woolsey*, 18 How. (U. S.), 331, where the directors of a bank refused to take the proper measures to resist the collection of a tax, which they themselves believed to have been imposed upon them in violation of their charter, this refusal amounted to a breach of trust, and a stockholder was held competent to file a bill in chancery asking such remedy as the case might require.

The directors of a corporation are, however, as to all purposes of dealing with others, the corporation itself, and when convened as a board they are the primary possessors of all the powers possessed by the corporation. What they do as the representatives of the corporation the corporation itself is deemed to do: *Hoyt v. Thompson*, 19 N. Y., 207; *Burrill v. Nehant Bank*, 2 Metc. (Mass.), 163; *Star Line v. Van Vliet*, 43 Mich., 364; *Genessee Sav. Bank v. Michigan Barge Co.* 52 Mich., 438; 6 *Amer. & Eng. Corp. Cas.*, 253; *Cleveland & M. R. Co. v. Himrod Furnace Co.*, 37 Ohio St., 321.

It follows from this that the stockholders of a corporation have no right to control or interfere with the management of the business and the concerns of the company by the directors. The authority of

the board of directors is derived from the unanimous agreement of the stockholders expressed in their charter or articles of association, and hence these powers which it is intended shall belong to the directors exclusively, cannot be impaired by the shareholders: *Tuscaloosa Manufacturing Co. v. Cox*, 68 Ala., 71; *Perry v. Tuscaloosa Cotton Seed Oil Mill Co. (Ala.)*, 33 Am. & Eng. Corp. Cas., 346; *Sims v. Brooklyn Street R. Co.*, 37 Ohio St., 556; *Pratt v. Pratt*, 33 Conn., 446.

This is well settled, therefore, that the board of directors of a corporation cannot be controlled in the exercise of the discretionary powers conferred upon them; the courts will not interfere at the suit of a shareholder to redress an alleged injury suffered by the corporation through some act of the directors, performed in good faith, and within the scope of their powers. All questions of expediency and economy, within the limits of their powers, must be left to the free exercise of their judgment, and remedy cannot be had by application to the courts.

In *Dudley v. Kentucky High School*, 9 Bush. (Ky.), 576, the corporation was authorized by its charter "to receive and hold for the benefit of a high school any lands, by gift, devise, donation, contract, or purchase." A stockholder brought suit to enjoin a contemplated purchase of real estate, setting out that the corporation was unable to pay the contemplated price, and that the result of the purchase, if consummated, would be the bankruptcy of the corporation, but did not allege that the lands were not to be held for the benefit of the school. It was held that the petition did not show a

cause of action. The Court said: "The corporation's charter empowers it to make purchases of land, to contract debts, and to issue bonds to a certain amount; and if these powers are so exercised as to result in loss to the stockholders, it is a misfortune against which the courts can afford no protection." See, also, *Boyd v. Sims*, 87 Tenn., 771; *Ogelsby v. Attril*, 105 U. S.: 605; *Banet v. Alton & S. R. Co.*, 13 Ill., 504; *Bardstown & G. R. Turnpike Co. v. Rodman (Ky.)*, 13 S.W. Rep., 918.

The rule that the court will not interfere in questions of expediency or economy has been applied in actions by stockholders to prevent the directors of a manufacturing corporation from using a large surplus for the erection of an additional factory, and to compel them to distribute it among the stockholders: *Pratt v. Pratt, Read & Co.*, 33 Conn., 446; to an action to set aside certain subscriptions for a portion of the authorized capital of the company taken by the directors: *Sims v. Brooklyn Street R. Co.*, 37 Ohio St., 556; 4 Am. and Eng. R. Cas., 132; and to an action by stockholders of a railroad company to prevent the extension of the railroad, and to prevent the directors from using the corporate assets therefor: *Moses v. Thompkins*, 84 Ala., 613; 21 Am. and Eng. Corp. Cas., 634.

The courts will not inquire as to the wisdom of an assessment, or its necessity at the time, or the motives which prompted it, if it be within the legitimate authority of the directors to levy it, and the objects for which the company was incorporated will justify the expenditure of the money to be raised. Directors of a turnpike company,

being authorized by statute to remove any of the gates of the company when it will be for the interest of the road, cannot, as long as they act, in good faith, be restrained at the suit of the stockholders from exercising this power and the power to sell the abandoned toll houses: *Bardstown & G. R. T. Co. v. Rodman* (Ky.), 13 S. W. Rep., 917. On account of the vast increase in the number of corporations and the purposes for which they are formed in this country, and the necessity for the exercise by their officers and managing boards of wide discretionary powers, courts of the present period incline to deal with them very liberally, both in construing their express, and in granting their implied, authority. In doing so, they have to a certain extent relaxed the former rule on this subject. At an earlier period they were reluctant to concede powers to the directors beyond a strict construction of the charter and by-laws: *Whitewell v. Barner*, 20 Vt., 425; see also, *Augusta Bank v. Hamblett*, 35 Me., 491; *Dispatch Line, etc., v. Bellamy Mfg. Co.*, 12 N. H., 225.

When acting as a board within the scope of their authority, however conferred, their acts are binding on the corporation, and all its legitimate business may be transacted by them without the express sanction of the stockholders. The latter have no right to interfere with management by the board. Courts will not, even on the petition of a majority, compel the directors to do an act contrary to their judgment. It is within the province of the board to declare dividends, for example, and it requires a strong case to induce courts to interfere with the exer-

cise of its discretion in that matter, in the absence of an improper or corrupt motive: *State v. Bank of La.*, 6 La., 745.

In *Small v. Minneapolis Electro Matrix Co.*, 45 Minn., 264, the Court said: "In the absence of express provision to the contrary, it is to be considered as the law concerning business corporations that their affairs are to be managed in the interest of their stockholders, and by directors or agents appointed by them. This is to be taken to be implied in the contract unless in some manner a different intention is expressed."

As to the right to impair the discretionary power of directors, *Morawetz* says, in § 243: "The managing agents of ordinary private corporations are invested with wide discretionary powers; if this were not so it would be impossible to carry on the business of such companies successfully. So long as the agents of a company act honestly within the powers conferred upon them by the charter, they cannot be controlled. The individual shareholders have no authority to dictate to the company's agents what policy they shall pursue, or to impair that discretion which was conferred upon them by the charter. If shareholders are dissatisfied with their agents, whom they have elected, their remedy is to elect other agents. It would be a violation of the charter contract and a wrong to every dissenting member to permit any portion of the shareholders to interfere with the discretionary powers which were intrusted to the agents of the corporation alone.

"It may, therefore, be stated as a rule that no shareholder can interfere with the management of the