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CORPORATIONS - LIABILITY OF OFFICER FOR PROFITS MADE OUT OF HIS OFFICE

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CORPORATIONS — LIABILITY OF OFFICER FOR PROFITS MADE OUT OF HIS OFFICE — *X*, in order to obtain funds with which to bid at a government sale of steel in 1919, offered defendant, president of the *Y* Bank, a one-half interest in the venture. Subsequently, defendant caused the bank to make large loans to the corporation organized to handle the steel transaction. The loans were

approved by the bank's loan committee on defendant's recommendation and were repaid in due time. Within the next three years defendant received from the steel enterprise $75,000 in "salary," $73,125 in dividends, and, finally, $200,000 for the sale of his stock. Upon the directors' refusal to sue, plaintiff-stockholders in the bank brought suit on behalf of their corporation to recover the sums so received by defendant. *Held*, that defendant breached his duty to the bank, the directors' refusal to sue was wrongful, and therefore plaintiffs were entitled to recover for the bank the profits taken in by defendant. *Fleishhaker v. Blum*, (C. C. A. 9th, 1940) 109 F. (2d) 543, certiorari denied (U. S. 1940) 61 S. Ct. 23, rehearing denied 9 U. S. L. WEEK 3124.

It would seem difficult in this case to deny that the corporation had been wronged and that defendant had violated the oft-repeated rule that an officer or director cannot use his office for his personal profit or benefit.[1] In these situations where officers and directors capitalize on their relation to the corporation, the breach of duty is the essence of the wrong, so that it becomes immaterial that no actual loss results [2] or that the corporation even realizes a gain.[3] Holding fiduciary or quasi-trust positions, officers are "required to exercise their best judgment and care in the interest of the corporation"; [4] compensation paid to them by third persons for loans made by the corporation, as in the principal case, can quite properly be regarded as consideration for the loan and as much the property of the corporation as the interest charged.[5] Defendant himself conceded all this, but denied that the profits were received in return for his obtaining the loans.[6] But since no other explanation was given, the decision could hardly have been different even in a court willing to consider the fairness of the transaction.[7] Particularly is this true here, since officers of a bank are

[1] In Boston Deep Sea Fishing & Ice Co. v. Ansell, 39 Ch. Div. 339 at 363 (1888), a case very similar in substance to the principal case and discussed in 81 SOL. J. 808 (1937), it was said by Bowen, L. J.: "there can be no question that an agent employed by a principal . . . to do business with another, who, unknown to that principal . . . takes from that other person a profit arising out of the business which he is employed to transact, is doing a wrongful act inconsistent with his duty toward his master, and the continuance of confidence between them." For an elaborate statement of the rule, see 3 FLETCHER, CYCLOPEDIA CORPORATIONS, perm. ed., § 884 (1931).

[2] Western States Life Ins. Co. v. Lockwood, 166 Cal. 185, 135 P. 496 (1913).

[3] Bird Coal & Iron Co. v. Humes, 157 Pa. St. 278, 27 A. 750 (1893); Blount County Bank v. Harvey, 215 Ala. 566, 112 So. 139 (1927).

[4] The quotation is from Blount County Bank v. Harvey, 215 Ala. 566 at 568, 112 So. 139 (1927), but the thought is reiterated in numerous cases.

[5] So held in Farmers' & Merchants' Bank of Los Angeles v. Downey, 53 Cal. 466 (1879), cited in and similar factually to the principal case.

[6] The letters which were in evidence would seem by themselves to be satisfactory direct proof that it was contemplated from the beginning that defendant was to obtain the funds from the bank. And certainly that would be a fair inference from the circumstances and absence of contrary evidence.

[7] See comment, 44 YALE L. J. 527 (1935), for a good discussion of the liberal and strict attitudes towards this problem. The principal case lends strength to the statement there made (p. 530) that "Recent disclosures concerning particular corporate organizations perhaps necessitate exacting judicial regulation and justify" application

apparently held to an even higher standard of fidelity than those of other corporations.[8]

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of the stricter position, which requires an accounting even though the dealings were fair, and the interests of the corporation were not unduly prejudiced.

[8] The "rules should be applied even more stringently to an officer and director of a bank who should be concerned with the welfare of depositors as well as that of customers and stockholders. . . . The law demands the fullest disclosure and fair dealings by a director or officer in his relations with a bank." Barber v. Kolowich, 283 Mich. 97 at 104, 105, 277 N. W. 189 (1938).