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Contracts by Outsiders to Influence Directors' Action

CORPORATIONS

CONTRACT BY OUTSIDERS TO INFLUENCE DIRECTORS' ACTION

Plaintiff seeks damages for breach of agreement by influential business men. The defendants for a good consideration promised to present plaintiff's name to the Board of Directors of Reo Motor Corporation and urge that he be offered a position as manager. None of the parties to the contract was alleged to be a stockholder in the corporation. It was alleged that the plan was in the best interests of the corporation and that because of defendant's breach, plaintiff was not offered a position. Held, demurrer overruled. The contract is not against public policy.[1]

As alleged, the defendants possessed sufficient influence to control the directors in exercising their judgment on corporate matters. Logically, public policy toward their contracts would be the same as that governing validity of directors' contracts. As a general rule directors owe a duty to the corporation to exercise individually and at the appointed time their best and impartial judgment on behalf of the corporation.[2] Stockholders likewise are not permitted to bind the directors in the exercise of this duty.[3] After acknowledging such a duty, the court asserts that it is not here in question as the defendants were not directors or stockholders. The court then analogizes the contract in the principal case to those made by directors

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[10] Chandler v. Peketz, 297 U. S. 609 (1936); Selig v. Hamilton, 234 U. S. 652 (1914); Swing v. Humbird, 94 Minn. 1, 101 N. W. 938 (1904); Stone v. Penn Yan, K. P. & B. Ry., 197 N. Y. 279, 90 N. E. 843 (1910). However, personal defenses may be asserted, if not in the nature of a collateral attack.

[11] Supreme Council of Royal Arcanum v. Green, 237 U. S. 531 (1915); Sliosburg v. New York Life Ins. Co., 244 N. Y. 482, 155 N. E. 749 (1927).

[12] The somewhat questionable rule employed by the court was expressed in WHARTON, CONFLICT OF LAWS (3d ed. 1905) § 401.

[13] New York Life Ins. Co. v. Street, 265 S. W. 397, 403 (Tex. Civ. App. 1924).

[1] Miller v. Vanderlip, 285 N.Y. 116, 33 N.E. (2d) 51 (1941).

[2] West v. Camden, 135 U.S. 507 (1890); 6 WILLISTON, CONTRACTS (Rev. ed. 1938) §1737; 2 FLETCHER, CORPORATIONS (Perm. ed. 1931) §280.

[3] McQuade v. Stoneham, 263 N.Y. 323, 189 N.E. 234 (1934), (1935) 44 YALE L.J. 873.

and stockholders, implying that it would not have been contrary to public policy if the defendants had been stockholders or directors.[4]

The voting trust has been expressly sanctioned in New York.[5] But a contract to influence directors is not "an agreement among a minority in number but a majority in shares for the purpose of obtaining control of the corporation by the election of particular directors."[6] The contract is rather an attempt to create a "passive directorate."[7] Such contracts are not voting trusts and therefore remain invalid as against public policy.[8]

In the case of *Clark v. Dodge*,[9] the same court held that where the contract of a director is alleged to be beneficial and there is nothing on the face of the contract which might be harmful to the corporation, it is such a slight infringement of the directors' duty that public policy does not require that it be invalidated. It is to be noted, however, that this test has been openly enunciated only in cases where a small "close" or "private" corporation was involved.[10] In such a corporation the sole owners are typically two or three stockholders who are also directors. It would seem that the courts, or preferably, the legislature should recognize this distinction and limit the test of possible harm to the corporation to such cases while retaining the stricter standard when dealing with a corporation having a large and diversified ownership as Reo Motor Corporation.[11]

While the courts are becoming more lenient in upholding contracts made by the stockholders and directors,[12] the contract in the principal case does not fall within either of the exceptions to the general rule discussed by the majority of the court. Therefore, the argument of Justice Lehman dissenting would seem to be the better interpretation of public policy. "A disappointed seeker of corporate office should not be allowed to recover damages...for the profits which he would have received if the men...who had influence sufficient to induce the board of directors to elect him had thereafter chosen to present and advocate a different plan for corporate action."[13]

It would seem to be contradictory and useless to forbid directors

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[4] *See* Brightman v. Bates, 175 Mass. 105, 55 N.E. 809 (1900) (voting trust not against public policy); Clark v. Dodge, 269 N.Y. 410, 199 N.E. 641 (1936) (no injury to the corporation apparent on the face of contract therefore valid).

[5] NEW YORK STOCK CORPORATION LAW §50.

[6] 6 WILLISTON, CONTRACTS (Rev. ed. 1938) §1736.

[7] Note (1935) 44 YALE L.J. 873, 875.

[8] Manson v. Curtis, 223 N.Y. 323, 119 N.E. 559 (1918); McQuade v. Stoneham, 263 N.Y. 323, 189 N.E. 234 (1934).

[9] 269 N.Y. 410, 199 N.E. 641 (1936).

[10] Clark v. Dodge, 269 N.Y. 410, 199 N.E. 641 (1936); Harris v. Magrill, 131 Misc. 380, 226 N.Y. Supp. 621 (1928). *See* Fells v. Katz, 256 N.Y. 67, 175 N.E. 516 (1931); Creed v. Copps, 103 Vt. 164, 152 Atl. 369 (1930).

[11] Weiner, *Legislative Recognition of the Close Corporation* (1929) 27 MICH. L.R. 273.

[12] See note 4 *supra*.

[13] Miller v. Vanderlip, 285 N.Y. 116, 33 N.E. (2d) 51, 58 (1941) (dissenting opinion).

to contract away their judgment on corporate matters and then permit a group having enough influence to control the directors to do that very thing, possibly against their better judgment. Although the plaintiff is left without remedy, public policy should discourage the formation of any such contracts by refusing to enforce them.