Wyoming Law Journal

Volume 7 | Number 2 Article 6

December 2019

Will Subsequent Appreciation Save Promoter His Secret Profit

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Recommended Citation
W. R. Boyer, *Will Subsequent Appreciation Save Promoter His Secret Profit*, 7 Wyo. L.J. 112 (1953)
Available at: https://scholarship.law.uwyo.edu/wlj/vol7/iss2/6

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exercise concurrent or independent power.[28] Thus, if state law comes into conflict with an act of Congress, the state law is superseded to the extent that the two are in conflict.[29] Section 21 (g) of the Act as previously noted gives sanction to the trustee to record his documents of title in those states authorizing this recording. The trustee, because of the Bankruptcy Act, would be the first taker of legal title. If the trustee cannot record because of lack of authorization or failure of the statute on recording to allow the recording, this would seem to impede the operation of the Bankruptcy Act. Therefore, it might be argued that as a matter of Federal law the trustee could take better title than that of a subsequent purchaser from the bankrupt who had recorded according to state law.

CONCLUSION

Section 21 (g) of the Bankruptcy Act was classified in the House Reports[30] under the general heading of "Amendments to Improve the Procedural Sections of the Act" and subheading "Safeguarding of Real Estate Title." The section was added to prevent the possibilities of fraud and its consequences on innocent purchasers from the bankrupt. In a state not allowing the recording by the trustee in bankruptcy, perhaps the legislative intent of the Bankruptcy Act is not met. Needless litigation may arise, creating unnecessary expense and wasting the court's very valuable time. Further, the attorney who must examine the title to real property is unessentially burdened. He must search the Federal District where the property is located and those Districts in which the grantors in the chain of title were domiciled, resided or had their principal place of business in order to ascertain if any of those grantors had been adjudicated a bankrupt.[31]

These obnoxious problems can be eliminated by state legislation specifically enabling the trustee in bankruptcy to record his title as provided for by the Bankruptcy Act. While it is conceivable that the courts themselves may construe the recording laws either as being qualified by the Bankruptcy Act or broad enough to admit such recording, in the light of the many decisions concerning construction of the recording statutes, this would be a major digression.

DONALD R. COLLINS

WILL SUBSEQUENT APPRECIATION SAVE PROMOTER HIS SECRET PROFIT

The Massachusetts Rule denies a corporation the power to consent to promoters' secret profits while the corporation is under the exclusive control of the promoters and the plan contemplates procuring subsequent

28. Houston v. More, 5 Wheat. (U.S.) 1, 5 L. Ed. 19 (1820).
29. People v. Erie Railroad Co., 198 N. Y. 369, 91 N. E. 849 (1910).
30. H. R. 1409 on H. R. 8046, 75th Congress, 1st Session (1937).
31. Patton on Titles, sec. 355.

stockholders. That rule was founded on the holding in the *Bigelow* case.[1] In that case promoters transferred mining property to a corporation of their own creation. The property transferred was worth appoximately one-third the par value of stock received by the promoters for it. All of the existing shareholders consented to the transfer, still the court held the promoters liable for the secret profit realized because the original plan included a sale to innocent subscribers at a later date. It is made clear in the *Bigelow* case that the technical wrong is to the corporation bringing the suit though the real injury is done the stockholders who are later asked to put cash into the enterprise. It was said that the conveyance to the corporation of overvalued property, when there are no uninformed subscribers, if nothing more is ever done, is not an actionable tort. Yet that case holds that the execution of an evil intent to procure subsequent stockholders extends backward to contaminate the sale and its profits. Under this rule promoters stand in a fiduciary position toward the corporation, as well when as a part of the scheme uninformed stockholders are expected to come in after the wrong has been perpetrated, as when at that time there are shareholders to whom no disclosure is made.[2] A secret profit is simply not consonant with the fiduciary relation of trust and confidence sustained by a promoter since it is the obligations of that relation which make it impossible for him to retain such a profit.[3]

This article proposes to ascertain the affect of the Massachusetts Rule of subsequent appreciation in value of that property conveyed by a promoter, first when that appreciation occurs before sale of stock to outsiders, and secondly after such sale but prior to action. It is to be noted that under the Federal Rule,[4] such appreciation would be of no consequence, because consent of the corporation at the time of transfer absolves the promoter of liability for secret profits though the plan is to sell stock to subsequent stockholders.

In spite of the Massachusetts Rule the first proposition, the effect of appreciation before outsiders come in, at least makes the accountability of a promoter for secret profits controversial. Favoring accountability is the trust relation of the promoter to the corporation, a relation that requires absolute fair dealing. Under the fiduciary duty the corporation, in order to hold a promoter accountable for such profit, need not have been damaged by the transaction in which it was made, except of course as it is damaged by the loss of profit to its treasury.[5] It is the obligation of the fiduciary relation that makes it impossible for the promoter to retain a profit secretly gained.[6] The promoter's liabliity is fixed and the right to

1. Old Dominion Copper Mining and Smelting Company v. Bigelow, 203 Mass. 159, 89 N.E. 193, 40 L.R.A. (N.S.) 314 (1909).
2. Ibid.
3. Fletcher, Cyclopedia Corporations, sec. 193 (Perm. Ed. 1931).
4. Old Dominion Copper Mining and Smelting Company v. Lewisohn, 210 U.S. 206, 28 S.Ct. 634, 52 L. Ed. 1025 (1907).
5. Western States Life Insurance Company v. Lockwood, 166 Cal. 185, 135 Pac. 496 (1913), rehearing denied Oct. 13, 1913.
6. Fletcher, Cyclopedia Corporations, sec. 193 (Perm. Ed. 1931).

recover established when it is made to appear that such secret profits were obtained without the knowledge or consent of the corporation and its members.[7] The promoter, sustaining the relation that he does, will not be permitted to retain a profit inequitably obtained.[8] On the other hand, receipt of full value by later purchasers should militate against accountability. It has been held that shareholders cannot recover from promoters where the transaction resulted in a profit to the corporation and its stock was worth at least par by reason of the lands conveyed, it being immaterial that such promoters reaped greater profits than other purchasers of shares.[9] Similarly, where it was claimed that shares of stock were improperly issued to promoters, the test was declared to be whether the corporation or any shareholder has suffered a tangible wrong or injury to his property rights.[10] And where the subsequent stockholders obtained full value it was held immaterial with what or how promoters paid for their stock; they cannot in any event claim injury through the purchase of stock which was worth at least what they paid for it.[11] Furthermore, another case held that if subsequent stockholders purchased with full opportunity for investigation into the conditions and assets of the corporation, and if the stock they purchased was fully worth the sum paid, there can be no element of injury or fraud as to them.[12] Thus it can be seen that a conflict exists, the great weight of authority appearing to hold a promoter liable for any profit taken secretly, subsequent developments notwithstanding.

Secondly, what affect will appreciation after sale to outsiders have on a promoter's liability for profits? The cases just noted disallowing recovery by a purchaser who received full value can be of little avail to the promoter. Obviously the stockholder was injured if he paid more than the stock was worth at the time of purchase. Such an injury is a constant and it does not disappear in event of a later increase in value of that stock. Certainly the liability imposed on a fiduciary by the Massachusetts Rule is unassailable when the stockholder has actually been injured. The result might be different if the promoter can show that no such injury occurred. The present value of the stock may support a contention that the property, when conveyed, was not overvalued. It has been recognized that property put into a new venture may, in combination with other units, attain a value which by itself it did not have.[13] Likewise, a showing of large dividends paid has been considered evidence of receipt by purchasers of full value for their stock.[14] What at first blush appeared to be an appreciation may only be an indication that the property when conveyed to the corporation was in fact worth all the corporation gave for it. But if the increase

7. Chandler v. Bacon, 30 Fed. 538 (C.C.D. Mass. 1886).
8. Woodbury Heights Land Company v. Loudenslager, 58 N.J.Eq. 556, 53 A. 671 (Ct. Err. & App. 1899).
9. Roberson v. Draney, 53 Utah 263, 178 Pac. 35 (1918), rehearing denied Jan. 15, 1919.
10. Ibid.
11. Eggleston v. Pantages, 93 Wash. 221, 160 Pac. 425 (1916).
12. Inland Nursery and Floral Company v. Rice, 57 Wash. 67, 106 Pac. 449 (1910).
13. Jeffs v. Utah Power and Light Company, 12 A. 2d 592 (Me. 1940).
14. Eggleston v. Pantages, 93 Wash. 221, 160 Pac. 425 (1916).

in value of the stock was occassioned by an appreciation after purchase, there is an injury. And it cannot be doubted that a corporation can recover secret profits of a fiduciary when shareholders have been injured.

The natural conclusion must be that courts will disallow a promoter his secret profit when the retroactive effect of the Massachusetts Rule has stamped him a fiduciary. This result probably follows though the property conveyed by a promoter has increased in value. The obligations of a fiduciary relationship make it impossible for him to retain such a profit. The promoter might have one contention. The basis of the corporate action is an injury to the stockholders. Might not the promoter urge that the Massachusetts Rule, already excepted to when a promoter takes the entire capital stock,[15] be susceptible to another exception when no injury has resulted to shareholders. This suggested exception may be substantiated by analogy to the refusal of courts to allow a preferred stockholder, who has received all he contracted for, to bring a promoter to account for secret profit on common stock. That denial, is, after all, based on an absence of injury![16]

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15. Jeffs v. Utah Power and Light Company, 12 A.2d 592 (Me. 1940).
16. Ibid.