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ADJUSTING TO THE MANAGERIAL REVOLUTION: THE LAW OF CORPORATIONS IN THE FEDERAL COURTS OF DELAWARE 1900-1941*

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This Article is the third in a series on the federal courts in Pennsylvania, New Jersey, and Delaware. The collective title of the series, which eventually will be published as a book as part of the Bicentennial, is *Studies in the History of the Third Circuit*. These essays border on the picaresque and do not purport to be a definitive history of the Third Circuit. The "Studies" simply attempt, for each of the states in the Third Circuit, to explore a particular problem in federal jurisprudence and to observe how the judges rationalized their decisions. In this postrealist¹ age, it seems appropriate to take as a given that the judges often found themselves choosing between conflicting or competing lines of authority, and that this problem was most acute when our nation was in a period of fundamental cultural upheaval. Accordingly, several periods of

* The research for this Article was done pursuant to a contract with the United States Government. The right of the Government to republish this material is preserved, and no claim to statutory copyright is established or asserted. As in the case of the two predecessors of this Article, see notes 2 & 3 *infra*, the judges of the Third Circuit's Bicentennial Committee, Chief Judge Collins J. Seitz, and Judges Albert B. Maris, George H. Barlow, John J. Gibbons, and Edward Dumbauld read several drafts, corrected obvious errors, and gave enthusiastic support. Thanks also are due to Dan Fischel, and to an anonymous member of the Delaware bar, who read an early manuscript and who made helpful critical suggestions. The staffs of the Morris Library of the University of Delaware, of the Eleutherian Mills Historical Association, and of the Delaware Historical Society gave graciously of their time and resources to permit Professor Presser to learn about Judges Bradford, Nields, and Morris, and the *Wilmington News-Journal* conducted a search of their morgue to unearth some delightful pieces on Morris and Nields. Research assistance was well provided by Gordon Hylton, Denison Hatch, Kenneth GoodSmith, Mitchell Duneir, and Sherri Morenes. William Hillstrom wrote a senior research paper for Professor Presser which brought to light several of the Delaware cases here discussed.

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1. Tushnet, *Post-Realist Legal Scholarship*, 1980 Wis. L. Rev. 1383.

such change in different Third Circuit states were picked for consideration. First, the era following the ratification of the Constitution was selected. The resulting study thus concerned the earliest federal judges, principally Richard Peters and Samuel Chase, and how they responded to the changes in American society caused by the American Revolution.² In particular, the article that resulted analyzed how the first federal judges of Pennsylvania confronted the perceived necessity for altering legal institutions in accordance with the dominant American political philosophy of popular sovereignty, and how the character of early American jurisprudence allowed them freedom to implement their own conceptions of the appropriate legal rules. The second study principally concerned John Thompson Nixon, District Court Judge of New Jersey from 1870-1889, as he sought to respond to the increased litigation caused by another "revolution," usually referred to as our "Industrial Revolution," following the American Civil War.³

The subject of this Article, the third of the Studies, is the manner in which the federal judges of Delaware and the Court of Appeals for the Third Circuit dealt in the early twentieth century with the continuing problems of American industrialization. The focus of this Article is somewhat narrower than the others because it is concerned simply with the doctrines of the law of corporations. As we shall see, however, it appears that the several judges whose work is examined here responded to still a third "revolution," the "managerial revolution" in the American economy. As was true in the previous studies, this Article's primary interest is in the choices which the judges made between conflicting doctrines. To place the legal doctrines in context, presented first is a sketch of the importance of the corporation to the late nineteenth and early twentieth century American economy, and of the attitudes of its critics.⁴ This section is followed by some general comments on the regulatory and facilitating activities of the New Jersey and Delaware legislatures, whose activities also are necessary to an understanding of the importance of the development of

2. Presser, *A Tale of Two Judges: Richard Peters, Samuel Chase, and The Broken Promise of Federalist Jurisprudence*, 73 Nw. U.L. Rev. 26 (1978).

3. Presser, *Judicial Ajax: John Thompson Nixon and the Federal Courts of New Jersey in the Late Nineteenth Century*, 76 Nw. U.L. Rev. 423 (1981).

4. On this point see also text accompanying notes 363-370 *infra*.

law in the federal courts. A final matter to be explored before examining the decisions of the judges is the character of the "managerial revolution" itself, which may have ultimately determined the climate in which the federal judges decided cases on corporate law. The remainder of the article examines the backgrounds and judicial opinions of the judges who sat on the bench of the United States District Court for the District of Delaware during this period, Judges Bradford, Morris, and Nields, and the disposition of some of these cases on appeal to the Court of Appeals for the Third Circuit. We are particularly concerned with the appeals reversed by, and the characteristics of, Circuit Judges Buffington and Davis.

The thesis of the Article is that, although the Delaware federal district court sought to respond to the managerial revolution by striking a delicate balance between the need for managerial autonomy and for corporate democracy and legitimacy, the balance was often upset on appeal, and tipped toward the needs of the corporate managers. A future study will examine how the somewhat skewed nature of decisionmaking by the Third Circuit in the early years of the twentieth century helped to determine the radically different nature of the operation of the United States Court of Appeals following still another revolution, the "Constitutional Revolution" of 1937. c

TOWARD THE MODERN BUSINESS CORPORATION

In the early nineteenth century, most economic activity was carried on by single proprietors or by partnerships, while the use of the corporate form was usually reserved for enterprises with a clear public interest, such as specially chartered monopolies formed to conduct charitable or transportation activities. By 1930, however, ninety percent of all products manufactured in the United States were made by corporations, and by 1950 most of the key industries were dominated by large firms.⁵ Since the rise of the giant corporations, it frequently has been argued that the doctrines of corporate law ought to be used as a means of holding corporate decisionmakers accountable to the public, or at least to all sharehold-

5. D. BOORSTIN, *THE AMERICANS: THE DEMOCRATIC EXPERIENCE* 420 (1973); A. CHANDLER, *THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS* 49 (1977).

ers. These concerns were not absent during the formative period of our law of corporations, the late nineteenth and early twentieth centuries, but it appears that other purposes, such as the maximization of the autonomy of corporate managers, may have taken priority.

The Managerial Revolution

As has recently been shown, a "managerial revolution" in American corporations came about because mass production rendered many market mechanisms obsolete. A haphazard network of wholesalers found it difficult to distribute the increased number of manufactured goods. Supply often outran demand, and manufacturers began to recognize that market mechanisms too often brought cutthroat competition and rapidly falling prices.⁶ The manufacturers eventually realized that, if mass production was to provide an adequate return on investment, manufacturers would have to remove both competitors and middlemen, and capture entire markets. By the end of the nineteenth century, then, some manufacturers had taken advantage of the new legal climate to initiate programs of vertical integration, setting up their own distribution units and buying out the producers of raw materials. The manufacturers were then in a position to buy out their competitors, and this resulted in the most pervasive merger movement this country has ever witnessed.⁷ By the turn of the century entire industries were controlled by a handful of giant firms, firms so large that the original magnates and entrepreneurs could not operate them alone. The manufacturers thus hired thousands of managers to staff their vast and far-flung enterprises, and to create central committees made up of department heads to formulate the broad policies of the enterprise. According to Alfred D. Chandler, "By then the visible hand of management replaced the invisible hand of market forces in coordinating the flow from the suppliers of raw materials to the ultimate consumers."⁸

As managers acquired control over the day-to-day allocation of

6. A Chandler, *The Role of Business in the United States: A Historical Survey*, in *THE AMERICAN BUSINESS CORPORATION: NEW PERSPECTIVES ON PROFIT AND PURPOSE* 39, 44 (1969).

7. *Id.* at 47.

8. A. CHANDLER, *supra* note 5, at 315.

goods in the economy, they acquired the knowledge and expertise necessary to plan the efficient functioning of business, and accordingly became more influential in corporate governance. By the late nineteenth century, in the larger corporations, there was a noticeably increased separation between control and ownership.⁹ Eventually, with increasing levels of capitalization in the large corporations and the resultant diffusion of stock ownership, often no stockholder or group of stockholders could obtain enough votes to defeat management in a proxy fight.¹⁰ Stockholders at the corporations' annual meetings often simply ratified the decisions of the board of directors and re-elected management's slate of directors. Following World War II, even when the legal "owners" were elected to the board of directors, "they [took] less and less part in the running of the business. Management consider[ed] them 'outsiders' and resent[ed] any interference from them."¹¹

By the beginning of the twentieth century, several state and national institutions chose to facilitate the concentration of power in management, thus establishing an enclave of corporate autonomy free from governmental influence. Moreover, apparently the states' liberalization of incorporation acts partially was designed to enhance the power of management and to restrict the authority of stockholders.¹² The Supreme Court's interpretation of the fourteenth amendment to hold that a corporation is a "person" within the meaning of that amendment and the Court's development of substantive due process "substantially curbed the legitimacy of government regulation of corporate behavior."¹³

The facilitation of corporate management was undertaken in an

9. P. DRUCKER, *THE NEW SOCIETY: THE ANATOMY OF THE INDUSTRIAL ORDER* 34 (1949). See also A. BERLE & G. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (rev. ed. 1967).

10. In 1932, the largest stockholder in America's most powerful railroad (the Pennsylvania Railroad) controlled 0.34% of the outstanding shares; the largest stockholder in the number one utility (American Telephone & Telegraph Company) controlled 0.7%, and the largest stockholder in the number one industrial company (United States Steel Corporation) controlled 0.9%. A. BERLE & G. MEANS, *supra* note 9, at 47.

11. P. DRUCKER, *supra* note 9, at 34.

12. Rutledge, *Significant Trends in Modern Incorporation Statutes*, 22 WASH. U.L.Q. 305, 312 (1937). Rutledge laments that "the individual stockholder has been placed almost in the position of holding a 'pig-in-a-poke.'" *Id.*

13. J. HURST, *THE LEGITIMACY OF THE BUSINESS CORPORATION IN THE LAW OF THE UNITED STATES: 1780-1970*, at 66 (1970).

atmosphere in which altruism was still present. Government officials recognized the advantages of corporate autonomy to the productive capacity of the country. By the turn of the century, corporations were turning out sixty-six percent of the United States' manufactured output, and this figure rose to eighty-seven percent by 1920.¹⁴ According to Hurst, "[N]o social goal was dearer to the late-nineteenth-century United States than increase of economic productivity [,and] . . . the corporation . . . emerged as the principal instrument for organizing large business enterprise."¹⁵

Delaware—The New Home of Corporations

The modern corporation probably first flourished under the New Jersey Incorporation Act of 1896,¹⁶ but its greatest friend was to be the legislature of the state of Delaware.¹⁷ Both Delaware and New Jersey adopted a policy of minimum regulation of corporations, and firms were soon flocking to those states to incorporate. As a result, federal judges in the district of Delaware were to play an important role in the development of the modern corporation. With many interstate disputes arising from the widespread activities and policies of Delaware corporations, the federal courts' attitudes toward the corporate scheme created by the Delaware legislature in large part determined whether the legislative intent respecting corporations would be implemented. Before studying the activities of the federal courts, however, it is important to understand the nature of the legislative schemes which the courts were called upon to interpret.

THE LEGISLATURES AND THE CORPORATIONS

In the late nineteenth century, especially in transportation and manufacturing, corporations and "trusts" rapidly became the predominant form of economic organization, and often were able to drive smaller enterprises out of the market. Combinations, acquisitions, and mergers often allowed firms to take advantage of econo-

14. A. BERLE & G. MEANS, *supra* note 9, at 40 n.21.

15. J. HURST, *supra* note 13, at 68.

16. 1896 N.J. Laws ch. 185.

17. See, e.g., Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663 (1974).

mies of scale and lower prices to a point that made operation by smaller firms unprofitable. Some industrial magnates of this era accumulated fabulous wealth, occasionally enough to extend loans to the federal government.¹⁸

In the early years of this period, however, most corporations were subject to state regulation which limited capital stock and allowed for continual judicial interference in corporate affairs. In Delaware, for example, an 1871 statute fixed maximum and minimum levels of capital stock at \$100,000 and \$10,000, respectively.¹⁹ Such limitations on levels of capital stock meant that no legal means existed by which corporations could merge into giant firms capable of dominating entire industries. Further, states also required corporations to adhere closely to the business purposes set forth in their charters, thereby preventing corporate diversification and vertical integration.²⁰ Finally, the states did not allow corporations to amend the scheme of shareholder democracy mandated both by common law and by corporate charters, so that to the extent that democratic processes slowed decisionmaking, corporations were not necessarily readily adaptable to changing economic circumstances.²¹

Seeking the economic benefits of large-scale operation,²² entrepreneurs such as John D. Rockefeller first attempted to circumvent state regulation of corporations by concentrating capital in unincorporated "trusts." This scheme developed by the ingenious attorney Samuel C.T. Dodd in 1879 for Rockefeller's Standard Oil Company,²³ was an arrangement in which several corporations put their properties under the control of a group of trustees who then operated the enterprises in concert.²⁴ The trust avoided the pitfalls of corporate law, but the arrangement had weaknesses. If a number of

18. Indeed, some observers believed that at least one enterprise, J.P. Morgan & Company, was profiteering more than lending. In any event, Morgan's banking group controlled enough capital to obtain half the gold in Europe in 1895. H. FAULKNER, *POLITICS, REFORM AND EXPANSION* 155, 156 (1959).

19. 14 Del. Laws ch. 152 (1871).

20. See A. BERLE & G. MEANS, *supra* note 9, at 122.

21. See *id.* at 123-24.

22. See D. BOORSTIN, *supra* note 5, at 416.

23. *Id.* at 417.

24. *Id.* at 416; T. MANNING, *THE STANDARD OIL COMPANY: THE RISE OF A NATIONAL MONOPOLY* 16 (1960).

corporations in the trust disagreed with the majority, they could leave the trust, causing a renewal of costly competition. Further, the trust device was endangered in 1890 when Congress passed the Sherman Antitrust Act.

Perceiving an opportunity for state gain, the New Jersey legislature soon came to the rescue by enacting a series of new corporation statutes. These laws permitted unlimited capitalization and encouraged holding companies. The laws eliminated or greatly liberalized earlier laws that imposed limits on corporate purpose and duration. Finally, by 1896, the revised New Jersey incorporation act's "self-determination clause" permitted corporations to amend their charters to modify, regulate, or create corporate powers, so long as these amendments were not contrary to other provisions of state law.²⁵ In short, these revisions "turned corporate law inside out" by changing the long-standing rule that corporations could exercise only those powers expressly granted by the legislature.²⁶

Many enterprises soon relocated in New Jersey, and incorporation fees began to supply a large part of government revenue. By 1902 New Jersey was able to abolish its property taxes, and by 1905 it had a three million dollar surplus in its treasury.²⁷ Across the state line, Delaware was growing "gangrened with envy at the spectacle of the truck-patchers, sand-duners, and mosquito wafters of New Jersey getting all the money in the country into her coffers."²⁸ Thus, in 1899 Delaware enacted its own liberal incorporation statute modeled on New Jersey's incorporation act.²⁹

25. Seligman, *A Brief History of Delaware's General Corporation Law of 1899*, DEL. J. CORP. L. 249, 261 (1976). The New Jersey incorporation statutes did not expressly legalize holding companies. Rather, the provision allowing corporations to hold the stock of other corporations was held to be broad enough to include the creation of holding companies. Samuel C.T. Dodd devised the holding company as a form of economic organization when the Standard Oil Trust was held to be illegal. See D. BOORSTIN, *supra* note 5, at 419.

26. Seligman, *supra* note 25, at 264.

27. *Id.* at 268.

28. *Little Delaware Makes a Bid for the Organization of Trusts*, 33 AM. L. REV. 418, 419 (1899).

29. For example, Delaware's "self-determination clause" provided that:

The Certificate of Incorporation may contain any provision which the incorporators may choose to insert for the management of the business and for the conduct of the affairs of the corporation, and any provisions creating, defining, limiting and regulating the powers of the corporation, the directors and the stockholders, or any class of the stockholders . . . provided, such provi-

Even though Delaware sought to take advantage of market competition by charging a lower incorporation fee, Delaware's statutes initially attracted few corporations to the state. This lack of success probably was because potential incorporators were suspicious of what appeared to be Delaware's sudden "camp-meeting" conversion, and thus decided not to leave states where corporate policy had become stable.³⁰ This trend changed in 1913 when New Jersey's Governor Woodrow Wilson destroyed that state's popularity among incorporators by encouraging the enactment of laws decidedly unfavorable to corporate autonomy. Corporate regulation was a part of Wilson's general reform program which was directed at everything from public utilities to high food prices.³¹ Governor Wilson's attempts to circumscribe corporations reflected a still widespread hostility toward corporations in particular and the concentration of economic power in general. In his inaugural address, for example, Wilson promised to enact legislation that would "prevent the abuse of the privilege of incorporation which has in recent years brought so much discredit upon our State." Legislation was necessary, Wilson believed, "to prescribe methods by which the public shall be safeguarded against fraud, deception, extortion, and every abuse of its confidence."³² Wilson reasoned that corporate regulation was necessary to protect both small stockholders and the public from exploitation by corporate managers and others who had been "preying upon them."³³

As New Jersey seemed to perform a complete reversal to demand greater corporate responsibility, Delaware became "the happy hunting ground of the corporate promoter."³⁴ Considerable advantages accrued to Delaware from this situation. The revenue generated by the state's incorporating fees significantly eased the tax burden on its citizens, and from 1913 to 1934 franchise taxes

sions are not contrary to the laws of this State.

Del. Corporation Law art. 1, § 4 (1928).

30. Stoke, *Economic Influence Upon the Corporation Laws of New Jersey*, 38 J. POL. ECON. 551, 576 (1930).

31. D. LOCKARD, *THE NEW JERSEY GOVERNOR: A STUDY IN POLITICAL POWER* 108 (1964).

32. See Woodrow Wilson's Inaugural Speech, quoted in D. HIRST, *WOODROW WILSON: REFORM GOVERNOR* 168, 169 (1965).

33. *Id.* at 163.

34. Dodd, *Statutory Developments in Business Corporation Law, 1886-1936*, 50 HARV. L. REV. 27, 27 (1936).

and related fees contributed an average of twenty-five percent of Delaware's total state revenues.³⁵ Accordingly, from time to time the Delaware legislature further amended its incorporation statutes to facilitate corporate formation and to enlarge the range of corporate autonomy.³⁶ It is generally concluded that, under the new Delaware corporation laws, ideas of corporate democracy were of secondary importance, as "the various amendments of the Delaware Act tended to concentrate in the board of directors the exercise of powers which had heretofore required ratification by the stockholders."³⁷

THE DELAWARE FEDERAL DISTRICT COURT: WORKING TOWARD THE BALANCE

During the first forty years of the twentieth century the Delaware federal district court was confronted with the first important series of corporate law cases which followed both the managerial revolution and Delaware's liberal incorporation statutes. Apparently eager to please both stockholders and corporate management, the Delaware federal court struck a delicate balance between corporate democracy and managerial autonomy.

The Judges

Court opinions often reflect, in varying degrees, the personal attitudes and preferences of the presiding judge. With this observation in mind, it is useful briefly to trace the backgrounds of the three Delaware federal district judges who sat during the first forty years of the twentieth century, emphasizing their association with, and opinions on, corporations and corporate officers.

1. *Edward G. Bradford, Jr*

Edward G. Bradford, Jr. served as a federal district judge in Delaware from 1897 to 1918. Judge Bradford, through his marriage to Eleuthora Du Pont, was connected with the Du Ponts, the richest

35. Seligman, *supra* note 25, at 276.

36. See, e.g., Berle, *Investors and the Revised Delaware Corporation Act*, 29 COLUM. L. REV. 563, 563 (1929).

37. R. LARCOM, *THE DELAWARE CORPORATION* 154 (1937).

and most powerful family in Delaware, and the owners of E.I. Du Pont de Nemours & Company, one of the leading manufacturing firms in the country.

A state historian wrote that Bradford was "of a studious disposition,"³⁸ and John P. Nields, eulogizing Bradford in 1928, said that Bradford's moral indignation often reached the intensity of the "fire of Savanarola."³⁹ Bradford had acted on his beliefs at the state constitutional convention in 1897 where he advocated measures to prevent corruption and bribery at elections.⁴⁰

2. *Hugh M. Morris*

Hugh M. Morris, who succeeded Bradford, sat as federal district judge from 1918 to 1930. Before his appointment, Morris carried on "an excellent and lucrative"⁴¹ corporate practice with Willard Saulsbury, Delaware's United States Senator. Morris was a vice president of the Equitable Trust Company of Wilmington and a trustee of the Wilmington Trust Company. In addition, he was a director of the Delaware Power Company, the Delaware Light & Power Company, and the Philadelphia, Baltimore & Washington Railroad Company.⁴²

Morris was born in Delaware,⁴³ was a Son of the American Revolution, a leader in Delaware's Americanization movement,⁴⁴

38. W. BEVAN & E. WILLIAMS, *HISTORY OF DELAWARE: PAST AND PRESENT* 367 (1929).

39. *Id.* For an example of the Savanarola-like fire that blazed within Judge Bradford, see his letter to Francis G. Du Pont in which the judge describes his reaction to a "thoroughly bad man" as being "disgusted beyond measure." The man in question appears to have been a church official who allegedly committed "gross unusualities," and had "improper relations with a young woman." The Judge recommended to Du Pont that he "drop him *instantly*." Letter from Judge Bradford to Francis G. Du Pont (Nov. 14, 1893) (Accession 504, Box 21, Family Correspondence of Francis G. Du Pont, Eleutherian Mills Historical Society, Wilmington, Delaware.)

40. W. BEVAN & E. WILLIAMS, *supra* note 38, at 367.

41. *Id.* at 88.

42. CHASE, KRISLOV, BOYUM, & CLARK, *BIOGRAPHICAL DICTIONARY OF THE FEDERAL JUDICIARY* (1976).

43. N.Y. Times, Aug. 19, 1923, § 7, at 10, col. 8.

44. See *id.* Morris's concern for Americanization, however, was prompted in part by a fear of class warfare. In 1923 Morris told a group of naturalized citizens:

Every American citizen should have in his home a copy of the Declaration of Independence and the Constitution. Unless you and all other American citizens understand the principles of the Government you now have, it will be easy for visionaries, demagogues and those tirelessly scheming to destroy all

and a member of the Democratic party. Indeed, even while he was on the bench, he may have been advising the Chairman of the Democratic party on how to deal with the influence of the Republican Du Ponts in Delaware. In a letter dated October 22, 1920, apparently written by Judge Morris, he indicates that, "The worship of the Golden Calf in this community has gone to such an extent that the atmosphere reeks of the yellow rich." The letter acknowledges that Pierre S. Du Pont "is reputed to be a very good man," but that "[h]e is a sample of the very rich men who think that in some way the Almighty has made him [sic] a trustee of wealth and that his [sic] ideas regarding its management and disposition are infallible." Judge Morris laments in the letter that Pierre "is, of course, surrounded completely by a lot of boot licks praising his greatness, his generosity and infallibility."⁴⁵

3. *John P Nields*

John P Nields was appointed by President Hoover to replace Judge Morris in 1930 and sat on the federal bench until 1941. In contrast to the private beliefs of Judge Morris, Judge Nields, who appears to have been Pierre S. Du Pont's lawyer in connection with certain of Du Pont's charitable endeavors,⁴⁶ was convinced that Pierre was a "remarkable" man who was engaged in a "holy experiment" designed to better the education and the material well-being of the citizens of Delaware in a manner "so near the ideal that few can believe it today."⁴⁷ Nields thought that the contribution of the Du Pont Company to the Allied Armies in World War I, made possible by the company's "manufacturing experience and . . . well-trained organization," was the most "outstanding achievement" in Delaware history during the period from 1876 to 1926. Nields appears to have shared in the sentiment of Lord

government to induce you to exchange those principles for principles which deny to man the rights of life, liberty, property and the pursuit of happiness.

Id. col. 4.

45. A copy of the letter to the Honorable George White, Chairman of the Democratic Committee, is among Judge Morris's papers in the Morris Library's Special Collection, University of Delaware, Newark. The copy is not signed by Morris, but appears to be typed by the same machine that was used for his other correspondence.

46. See N.Y. Times, July 1, 1930, § 1, at 4.

47. J. Nields, September Twentieth: Delaware's Birthday 14-15 (September 20, 1926).

Moulton, who gave the Du Pont Company, J.P. Morgan & Company, and the Bethlehem Steel Company the credit for enabling the British and French armies to "hold their own" during the War.⁴⁸

Nields appears to have been on close personal terms with the son of the leader of the corporate bar, Josiah Marvel.⁴⁹ Nields also apparently traveled in rather aristocratic Delaware Republican and Episcopalian circles.⁵⁰ Nonetheless, Nields appears to have been greatly influenced by the career of Theodore Roosevelt and to have embraced what Nields perceived to be Roosevelt's commitment to "ideas of social and industrial justice."⁵¹ Nields noted that, when Roosevelt took over for the assassinated McKinley, Roosevelt was nothing less than "a hero [responding to] an Olympian summons," and subscribed to Roosevelt's opinion that "[t]he surest way to invite disaster is to be rich, aggressive, and unprepared."⁵² Yet Nields recognized that, after 1900, Americans clearly had decided against the notion "that the laissez faire doctrine should control legislators in dealing with vast corporate wealth and influence."⁵³

Judge Nields's attitude toward the South reveals a similar dichotomy in his beliefs. He appears to have believed that the Civil War was badly misnamed because that conflict was in reality "an attempt by the North, the stronger of two separate nations," to "attack, conquer and re-annex the weaker."⁵⁴ Even if the North was the aggressor against the weaker South, however, Nields believed that at least one of the South's postwar responses to build its social system, the Ku Klux Klan, was an "abomination of abominations."⁵⁵ Judge Nields's judicial treatment of the law of corporations and that of his brother district court judges show a

48. *Id.* at 8-9.

49. Josiah Marvel, Jr., was a member of the committee in charge of organizing Judge Nields's retirement ceremony in 1941. Proceedings in the District Court of the United States for the District of Delaware on September 30, 1941, in Connection with the Retirement of the Honorable John P. Nields 3 (1941).

50. CHASE, KRISLOV, BOYUM & CLARK, *supra* note 42.

51. Address by John P. Nields (Oct. 27, 1923) (Old Town Hall Leaflets, No. 1).

52. *Id.* at 6.

53. *Id.* at 3.

54. Address by John P. Nields (May 23, 1929) (given before Wilmington Rotary Club and Veterans of the Civil War, who were guests at the club).

55. Address by John P. Nields (Oct. 2, 1925) (given before Delaware Bar Association).

similar recognition of dichotomies and an attempt to achieve moderation.

The Bradford Period: Creating the Balance

1. Jones v Mutual Fidelity

Edward Bradford may have been the first modern Delaware federal court judge to seek to strike a balance between managerial autonomy and corporate democracy. Judge Bradford sought to create this balance in the context of cases involving corporate abuse of power. Perhaps the best example of Bradford's attitude toward corporate abuses comes in *Jones v. Mutual Fidelity Co.*⁵⁶ The defendant was a Delaware corporation which had sold "certificates of investment" to the plaintiffs, Tennessee residents. The certificates were vaguely worded, so that the investors actually were promised nothing by the Delaware corporation.⁵⁷ Bradford was convinced that the certificates were "ambiguous, misleading and obscure, and so artfully worded as to prove a snare to the ignorant and unwary," that the defendant had engaged in "fraudulent representation," and that the defendant hatched a "disreputable and overreaching scheme" accomplished by "deception and illegitimate means" which held out the promise of "well-nigh impossible profits."⁵⁸ There were two technical arguments, however, which Bradford could have used to dismiss the plaintiffs' claims. First, none of the individual plaintiffs had claims which were large enough to meet the \$2000 requirement for federal diversity jurisdiction,⁵⁹ although the aggregate of their claims was greater than \$2000. Second, the equitable remedy which the plaintiffs sought, namely placing the insolvent defendant in receivership and ordering a pro rata distribution of defendant's assets to its creditors, including the plaintiffs,⁶⁰ although provided for in a Delaware statute by application to the Delaware Chancellor,⁶¹ was not expressly authorized by any state or federal statute as a proceeding in the federal courts.

56. 123 F. 506 (D. Del. 1903).

57. *Id.*

58. *Id.* at 531.

59. *Id.* at 510.

60. *Id.* at 510, 512.

61. *Id.* at 511.

Bradford disposed of the jurisdictional amount issue by stating that the test for jurisdictional amount was not the plaintiffs' individual claims but the amount of corporate assets that would be placed in receivership if the plaintiffs succeeded.⁶² There appears to be some lower federal court authority which supported Judge Bradford, but there also appears to be several United States Supreme Court decisions which suggest that Judge Bradford's method of calculation of jurisdictional amount was too liberal.⁶³

The second issue, whether the federal court could apply the state equitable receivership statute, was a more difficult hurdle for Judge Bradford because the Supreme Court had explicitly stated in *Hollins v. Brierfield Coal & Iron Co.* that when the plaintiffs were unsecured creditors whose claims had not been reduced to judgment (as was the case in *Jones*):

It is the settled law of this court that such creditors cannot come into a court of equity to obtain the seizure of the property of their debtor, and its application to the satisfaction of their claims; and this, notwithstanding a statute of the state may authorize such a proceeding in the courts of the state. The line of demarcation between equitable and legal remedies in the Federal courts cannot be obliterated by state legislation.⁶⁴

Bradford dismissed this language, and perhaps the policy of strict construction of federal jurisdiction, with the observation that it was "mere obiter dictum."⁶⁵ Although Judge Bradford was reluctant to disagree with the clear language of the Supreme Court, he concluded that it would be an "absurdity"⁶⁶ to apply the Supreme Court's rule when refusing the parties equitable relief in the federal court "would defeat and practically nullify the equitable right created by [the state] statute."⁶⁷ Judge Bradford chose to reject the Supreme Court's reasoning, and instead relied on broad princi-

62. *Id.* at 512-14.

63. Compare, e.g., *Wheless v. St. Louis*, 180 U.S. 379 (1901) (Bradford's calculation too liberal) with *Taylor v. Decator Mineral & Land Co.* 112 F. 449 (N.D. Ala. 1901) (Bradford's calculation correct).

64. *Hollins v. Brierfield Coal & Iron Co.*, 150 U.S. 371 (1893), quoted in *Jones v. Mutual Fidelity Co.*, 123 F. at 525.

65. *Jones v. Mutual Fidelity Co.*, 123 F. at 525.

66. *Id.* at 527.

67. *Id.*

ples such as "a party by going into a national court does not lose any right or appropriate remedy of which he might have availed himself in the state courts,"⁶⁸ and "justice and positive rights, founded both on valid statutes and valid contracts, should not be sacrificed to mere questions of mode and form."⁶⁹

Perhaps the most impressive judicial legerdemain in Bradford's opinion, however, was in the final few paragraphs where he turned a case of fraud,⁷⁰ which the plaintiffs might have had difficulty proving, into a case "on the common count in assumpsit for money had and received,"⁷¹ for which the standard of proof probably could be met simply by the plaintiffs' entering their certificates of investment into evidence. Specifically, Bradford observed that, under Tennessee law, a foreign corporation seeking to do business in the state was required to file a copy of its charter with the Tennessee secretary of state, and that failure to file the charter made it "unlawful for any foreign corporation to do business in the state."⁷² The defendant never had made the requisite filing.⁷³ This meant, Bradford held, that the transaction by which the "certificates of investment" were sold to the plaintiffs was "unlawful."⁷⁴ Thus, the plaintiffs, who Bradford without explanation said "were not chargeable with knowledge of the fact that the defendant had failed to comply with the requirements of the Tennessee statute," were "innocent parties to unlawful and void contracts."⁷⁵ Despite the fact that the plaintiffs hardly could be called "innocent" in that they sought "impossible profits,"⁷⁶ Bradford declared that they were entitled to be treated as creditors and recover from the defendant "all moneys paid by them to it on account of the prohibited contracts."⁷⁷ Bradford cited a Supreme Court opinion and a treatise that mandated such treatment for "innocent" parties

68. *Id.* at 517.

69. *Id.* at 523 (quoting *Brine v. Insurance Co.*, 96 U.S. 627, 634 (1877)).

70. *Id.* at 531.

71. *Id.* at 533.

72. 1891 Tenn. Pub. Acts, p. 264, ch. 122.

73. *Jones v. Mutual Fidelity Co.*, 123 F. at 531.

74. *Id.* at 532.

75. *Id.* at 533.

76. *Id.* at 531.

77. *Id.* at 533.

who had lost money under illegal contracts,⁷⁸ but, other than pointing out the plaintiffs' gullibility, avarice, and ignorance of the Tennessee statute, Bradford offered no explanation of their innocence.⁷⁹

In *Jones*, Bradford apparently refused to follow relevant federal precedent, judicially expanded the boundaries of federal jurisdiction, and used Tennessee state law as a pretext for granting relief where he believed a Delaware corporation had defrauded investors. Decisions such as *Jones*, Bradford might reasonably have believed, would tend to assure the public that the federal judiciary would take all means at its disposal to ensure that corporations conducted their activities in a manner consistent not only with the law, but also with basic principles of fairness.

Similar indications of Judge Bradford's vigilant willingness to act in cases of "fraudulent representation," "disreputable schemes," or "deception"⁸⁰ occur in several other corporations cases. It appears, however, that Bradford generally required substantial evidence of wrongdoing before he concluded that the officers of a corporation were liable for their conduct.

2. Wright, Beltz, and Sellman

In *Wright v. Barnard*,⁸¹ a case decided near the end of Judge Bradford's term, Wright, the complainant and general manager of the company,⁸² sued the company's vice president and secretary-treasurer for fraud and breach of contract.⁸³ Wright alleged that the defendants, who actually held only a minority of the company's stock,⁸⁴ falsely represented that they owned all of the stock⁸⁵ and that they would increase the amount of stock and give Wright one-third stock ownership in the company if he would continue successfully to manage the company's business.⁸⁶ The officers of the

78. *Id.*

79. *Id.*

80. *Id.* at 531.

81. 248 F 756 (D. Del. 1917).

82. *See id.* at 759.

83. *Id.*

84. *Id.*

85. *Id.*

86. *See id.* at 760-63. The officers' primary concern was that Wright would largely in-

company, while taking advantage of Wright's services,⁸⁷ had fraudulently failed to carry out their promises to see that the company was reorganized in a manner which would permit Wright to own shares.⁸⁸

In holding the company liable for the misconduct of its officers, Bradford was careful to note that "[i]t is difficult to conceive of a case more permeated with fraud than that now before this court."⁸⁹ Bradford further stated that "[t]he evidence has established to a moral certainty fraud and wrongdoing."⁹⁰ In addition, by holding the company liable, Judge Bradford actually was rewarding one who had demonstrated an ability and desire diligently to exercise managerial skill.⁹¹ Normally, limiting the liability of a corporation and its officers in cases of managerial discretion resulted in encouraging that discretion; but where, as here, the primary manager of the company was the one who sought compensation for fraud, and where the evidence seemed clear, it was easy to strike the balance in a manner that afforded the manager relief.

One other case in the last year of Judge Bradford's service underscores his commitment to facilitating the development of corporate enterprise through the protection of productive individuals, even if it meant subjecting others in the corporation to liability. In *Beltz v. Great Western Lead Manufacturing Co.*,⁹² Judge Bradford was presented with another case involving a manager, this time a mining superintendent, John Beltz, who sought relief against the corporation for which he had served. Apparently no fraud was involved,⁹³ but several corporate associates failed to honor a contractual promise to deliver one-fifth of the capital stock of the corporation in return for the complainant's delivery of all

crease the sales of the business. *Id.* at 760.

87. *Id.* at 767. "[N]otwithstanding default on the part of [the officers], the complainant, who was wholly unaware of the falsity of their statements as to stock ownership and control, continued actively and loyally to co-operate with them for the advancement of the company's business and welfare." *Id.*

88. *Id.* at 766.

89. *Id.* at 772.

90. *Id.*

91. See text accompanying notes 84-88 *supra*.

92. 251 F. 696 (D. Del. 1918).

93. The action was based on breach of contract. See *id.* at 697-98.

the capital stock in a predecessor corporation.⁹⁴ The complainant invested considerable time and money in the old corporation, bringing a deposit of ore nearly to the stage where it would yield profitable results.⁹⁵ The complainant, the court observed, was a man "of but little education,"⁹⁶ suggesting that this might account for the "inconsistences and discrepancies on minor points"⁹⁷ in his testimony. Taking account of how the individual defendants actually had allowed many others to profit from the initial success of the company,⁹⁸ and how poorly the complainant fared at the hands of the new corporation,⁹⁹ Bradford declared:

[I]t is against the dictates of self-interest and the known rules of human conduct that after acquiring the mining lease and turning it over to the [new] company in consideration of which its total capital stock was issued, he should . . . have intended or contemplated that [the stock] would be so manipulated as to produce the grotesque result the defendants seek to justify.¹⁰⁰

The new corporation in the meantime had gone into bankruptcy,¹⁰¹ but Bradford proceeded to hold four individual defendants, who had been the founders of the new corporation along with the complainant, personally liable for their failure to deliver stock to the complainant according to the agreement.¹⁰² Bradford gave the complainant the benefit of the doubt in resolving some inconsistencies in the testimony,¹⁰³ and it seems likely, given his expressed

94. *Id.* The corporate name remained the same, but the scope of corporate activities expanded.

95. *Id.* at 697.

96. *Id.* at 706.

97. *Id.*

98. *See id.* The court observed that the complainant "received by way of dividends only \$950 as against \$8,942.50, received by each of the other parties to the agreement." *Id.*

99. *Id.*

100. *Id.*

101. *Id.* at 707.

102. *Id.*

103. For example, when Beltz delivered all of the stock to the treasurer of the company, it was unclear why he delivered the stock for cancellation, which reduced the capital stock of the company from \$500,000 to \$10,000. Judge Bradford observed that, "it appears that the stock was reduced from the larger to the smaller sum in order to avoid the payment of an undue amount of tax, but not for the purpose of altering the proportionate interests of [the corporate associates] and Beltz in the capital stock of the company." *Id.* at 702.

Similarly, the defendants contended that, because Beltz paid only \$475 under the provi-

views in the two cases considered earlier, that the initiative and expense undertaken by the complainant as a manager for the company, as well as the defendants' breach of contract, played a role in his decision.

Other Bradford judicial opinions indicate, however, that he was less inclined to grant relief in the case of nonmanagerial shareholders, or of creditors who sought relief against corporate officials, when there was no clear and convincing proof of fraud or deception. In *Sellman v. German Union Fire Insurance Co.*,¹⁰⁴ for example, Judge Bradford was asked, in his role as an equity judge, to appoint a receiver for a corporation, and to direct the receiver to wind up the corporation's affairs, distribute assets, and restrain the defendant's officers from interfering with the granting of relief.¹⁰⁵ The plaintiffs were several stockholders and creditors of the company¹⁰⁶ who asked for relief on the grounds that the company's board of directors, through "various misrepresentations and fraudulent acts and purposes,"¹⁰⁷ had so disregarded the rights of the stockholders and creditors as to bring "such peril to the corporation"¹⁰⁸ that the drastic relief they called for was necessary. Bradford observed that there were "many authorities" which stated that, "where the facts clearly disclose such fraudulent or wrongful management of its business and affairs as to produce a conviction that further control of the corporation by its board would result in the destruction of its business or create a great and unnecessary loss to its creditors and stockholders," relief of the

sions of the contract, he was entitled to no further credits on his stock subscription. *Id.* at 703. Although the Pennsylvania Court of Common Pleas in an earlier decision on a collateral issue had found that Beltz paid only \$475, Bradford ruled that the court of common pleas' finding was "made under circumstances which deprive it of any binding effect upon the complainant, and further, was clearly erroneous." *Id.* Beltz, arguing that he had paid the full amount under the contract, contended that his \$125 per month salary was applied against his monthly obligations. *Id.* at 704. The president of the company denied that such an arrangement was made with Beltz. Bradford, after considering some rather ambiguous statements which he thought corroborated Beltz's argument, stated that, "the complainant's statement on this subject is natural and inherently probable." *Id.*

104. 184 F. 977 (D. Del. 1909).

105. *Id.* at 978.

106. *Id.* at 977.

107. *Id.*

108. *Id.*

sort sought by the plaintiffs might be granted.¹⁰⁹

In *Sellman*, however, Bradford refused to grant the requested relief.¹¹⁰ Bradford reasoned that "the stockholders are by no means unanimous on the question of the wisdom or propriety of the relief sought by the bill,"¹¹¹ and "in the case of a corporation which is a solvent and going concern the proofs must be clear and convincing to justify the winding up of its business and affairs."¹¹² Stating what seems to have been the assumption of Delaware law that a strong presumption of legitimacy was to be accorded by Delaware law to the acts of managers, or at least to the board of directors of corporations, Bradford observed:

[T]he board of directors of a corporation is charged by law with the control of its business and affairs; and when the law making power has declared that the business and affairs of a corporation, created and organized under that power, shall be directed by its board, it ill-becomes courts created for the administration of law, unless under special and peculiar circumstances, to declare that its business and affairs shall not be directed by such a board.¹¹³

Thus, although Bradford intervened in corporate affairs, he attempted to balance any inclination to intervene by an attentiveness to the policies which he could discern behind the Delaware Incorporation Act, policies which dictated a maximum of autonomy for the managers of corporations. When obvious wrongdoing compelled Bradford to act, however, as the *Jones* and *Beltz* cases demonstrate, he was somehow able to brush aside conflicting legal doctrines and dispel doubts about evidence in a manner which sat-

109. *Id.* at 978.

110. *Id.* at 979.

111. *Id.* at 978.

112. *Id.*

113. *Id.* See *Carson v. Allegany Window Glass Co.*, 189 F. 791 (D. Del. 1911), in which Bradford denied relief similar to that sought in *Sellman*. In *Carson*, Bradford noted that he might grant a receivership in favor of stockholder complainants who alleged that the mismanagement and misrepresentations of corporate officers were injurious to the financial soundness, good will, and credit of a corporation if "strong and clear proof" were made that "fraudulent, wilful, or reckless mismanagement" threatened to destroy the business. Where there are differences of opinion among the stockholders, or where no other stockholders beside the complainant come forward to join in the prayer for relief, however, Bradford declared that the "strong and clear proof" standard cannot be met.

isfied his conscience.

3. *Du Pont v Du Pont*

Perhaps the most important corporations case decided by the Delaware federal district court during the early twentieth century was *Du Pont v. Du Pont*.¹¹⁴ The *Du Pont* litigation arose during Judge Bradford's term, but Judge J. Whitaker Thompson of the United States District Court for the Eastern District of Pennsylvania decided *Du Pont* because Bradford had connections by marriage to both sides in the dispute.

Although Judge Thompson was not a "permanent" Delaware federal district judge, and this article is primarily concerned with the "permanent" judges, the *Du Pont* case still merits serious consideration for several reasons. First, developments at *Du Pont*, a Delaware corporation, were crucial in the development of the modern corporation.¹¹⁵ Second, the views articulated by Thompson in the *Du Pont* decision bear a strong resemblance to Judge Bradford's views in similar corporations cases. Further, the reaction of the court of appeals to Thompson's *Du Pont* opinion appears to be of a piece with the court of appeals' treatment of several other opinions by the "permanent" Delaware federal district judges.¹¹⁶

Du Pont concerned the efforts of Pierre S. Du Pont to assume control of E. I. Du Pont de Nemours & Company and to diminish the influence of his cousins, Alfred and William. This controversy was one of the most important events in the career of Pierre S. Du Pont, as he began to develop his plans to transform *Du Pont* from a relatively small gunpowder company into one of the world's great industrial giants. Pierre was a pioneer in the emerging business arts of vertical integration and financial management, and his efforts on behalf of *Du Pont* were profoundly important in bringing

114. 234 F 459 (D. Del. 1916); 242 F 98 (D. Del. 1917); 251 F 937 (D. Del. 1918), *modified*, 256 F 129 (3d Cir.), *cert. denied*, 250 U.S. 642 (1919). The first opinion is an interlocutory decree by Judge Thompson; the second and third opinions are decisions on the merits of the case.

115. For evaluations of the importance of the activities of Pierre S. Du Pont and the *Du Pont* company to the development of the modern corporation, see A. CHANDLER & S. SALS-BURY, *PIERRE S. DU PONT AND THE MAKING OF THE MODERN CORPORATION* (1971), and A. CHANDLER, *supra* note 5, at 438-50.

116. See text accompanying notes 318-362 *infra*.

about the "managerial revolution" which ensured the hegemony of American business in the mid-twentieth century ¹¹⁷

a. *Background*

The Du Pont litigation arose because of the manner in which Pierre S. Du Pont acquired control of the company. The key act by Pierre was the formation of a holding company and the purchase of 63,000 shares of Du Pont stock from Pierre's cousin, T. Coleman Du Pont.¹¹⁸ This stock was the largest single block of stock in the company.¹¹⁹ The next two largest holdings had been those of Pierre himself, and of another cousin, Alfred Du Pont.¹²⁰ Before the holding company's purchase of Coleman's shares, Pierre, Alfred and Coleman had held the company's highest executive positions.¹²¹ In late 1914, however, Coleman was in need of liquid assets to enable him to purchase New York real estate and to pursue political ambitions. Accordingly, he offered to sell 20,700 shares of his common stock to the company at a price of \$160 per share.¹²² When communicating his offer to Pierre, who then was acting for the company, Coleman stated that he believed the stock to be worth at least \$200 per share because of the profits the company could expect to reap from gunpowder sales to the Allied nations then fighting in the World War.¹²³ The apparent generosity of Coleman's offer, in light of the value he placed on the stock, was a result of his expectation that the stock would be resold by the company under favorable terms to some of the company's junior executives.¹²⁴ The activities of these young executives already had resulted in great profit to Coleman and the other Du Ponts, and he felt them deserving of this consideration.¹²⁵

Pierre relayed Coleman's offer to the company's finance commit-

117. See sources cited in note 115 *supra*.

118. See *Du Pont v. Du Pont*, 242 F. 98, 101 (D. Del. 1917).

119. See *id.*

120. See *id.*

121. *Id.*

122. *Id.*

123. See *id.* at 103.

124. *Id.* at 101, 103-04.

125. *Id.* at 103-04.

tee,¹²⁶ which then included Pierre, Alfred, and still another cousin, William Du Pont.¹²⁷ Alfred appears to have been more pessimistic about the company's immediate prospects than was Coleman,¹²⁸ and while Alfred believed that the purchase for resale to the executives was a sound plan, he believed that a counteroffer should be made to Coleman of \$125 per share.¹²⁹ When the finance committee voted whether to accept Coleman's offer, William sided with Alfred.¹³⁰ Pierre voted to accept Coleman's \$160 offer.¹³¹ Thus, the majority of the committee present had voted *not* to accept the offer from Coleman. According to Alfred's and William's testimony at trial, however, the finance committee understood that Pierre would continue price negotiations with Coleman.¹³² Nevertheless, the minutes of the finance committee, signed by all parties, simply stated that Pierre was directed to inform Coleman that "we do not feel justified in paying more than \$125 per share for this stock."¹³³ Six days later, the report of the finance committee presented to the company's board of directors stated that "[t]he committee expressed the feeling that we are not justified in paying more than \$125 per share for that stock *and asked Mr P.S. du Pont to take the matter up with Mr T C. du Pont further*"¹³⁴ The evidence on whether Pierre was expected to continue to act on behalf of the finance committee once he had communicated the finance committee's rejection of Coleman's offer thus was contradictory. The minutes of the finance committee suggest a clear rejection and a limited duty simply to communicate this rejection to Coleman, but the report to the board of directors suggests a duty on Pierre to continue negotiations.

Pierre communicated the finance committee's rejection of the \$160 offer to Coleman's attorney, but he apparently did not suggest that the committee's \$125 counteroffer meant that the com-

126. *See id.* at 103.

127. *Id.* at 101.

128. *See id.* at 104.

129. *Id.* at 105.

130. *Id.*

131. *Id.*

132. *Id.* at 113-15.

133. *Id.* at 103.

134. *Id.* (emphasis added).

mittee contemplated continued negotiations.¹³⁵ Pierre proceeded to combine with a number of his associates, junior executives at Du Pont to whom Coleman had intended that his stock eventually be sold, to form a holding company, Du Pont Securities, which eventually reached agreement with Coleman for the purchase of *all* of his stock, 63,314 shares of common and 14,599 shares of preferred, at a price of \$200 per share for the common stock, and \$85 per share for the preferred.¹³⁶ The holding company then borrowed more than \$8.5 million in a loan from several banks brokered by J.P. Morgan & Company,¹³⁷ and the holding company designated a substantial portion of Coleman's stock as collateral for the loan.¹³⁸ Soon after the purchase was made public, Philip Du Pont, a Pennsylvania cousin, filed suit in federal court asking that an injunction be issued requiring that the holding company offer Coleman's stock to the Du Pont company on the grounds that, (1) Pierre had deceived both Coleman and the finance committee in a plot to obtain possession of Coleman's stock and control of Du Pont for himself,¹³⁹ and (2) Pierre had wrongfully used his position as vice president of Du Pont to secure the multi-million dollar loan needed to purchase Coleman's stock.¹⁴⁰ Philip may have been acting at Alfred's direction. In any event, Alfred soon joined Philip as a plaintiff.¹⁴¹

b. Du Pont v Du Pont I

The first issue resulting in an opinion in the *Du Pont* case¹⁴² was a matter of discovery. In an attempt to show that Pierre and his associates had wrongfully used their executive positions at Du Pont to secure the \$8.5 million loan, Philip Du Pont petitioned Judge Thompson to order Pierre to answer interrogatories concerning all the bank deposits that the Du Pont company had made

135. *Id.* at 105.

136. *Id.* at 101-02.

137. *Du Pont v. Du Pont*, 234 F at 460; 242 F at 119, 121.

138. 242 F at 102, 121.

139. *See id.*

140. *See id.*

141. The second *Du Pont* opinion lists Philip as "the original plaintiff," and notes that Alfred and others are "intervening plaintiffs." *Id.* at 100.

142. Thompson's interlocutory decree is reported at 234 F 459 (D. Del. 1916).

following the loan.¹⁴³ Philip maintained that he could show that Pierre and his associates directed the company's funds to the banks that had participated in the loan.¹⁴⁴ Judge Thompson dismissed the petition because the "mass of details" sought by the plaintiffs was "undoubtedly calculated to burden, oppress, and harass the corporation defendant."¹⁴⁵ The interrogatories appear to have been broadly drafted,¹⁴⁶ they were not restricted to matters involving the banks that had participated in the loan, but rather sought information concerning all banks holding Du Pont funds.¹⁴⁷

Judge Thompson had to make a decision common in discovery proceedings, namely, how to determine the appropriate balance between relevancy and materiality on the one hand, and burdensomeness on the other. Perhaps one can make too much of this relatively routine discovery decision, but it does not go too far to infer from Thompson's insistence on narrowly drawn interrogatories that, as may also be implied from Bradford's opinions, Thompson recognized the need to protect corporate management from undue harassment by dissatisfied stockholders.

In any event, it may be that Thompson's decree was prompted by concern more for Du Pont's banks than for Du Pont itself. Thompson stated that the decree was necessary to protect "banking institutions in no wise connected with the cause, from being unduly oppressed and harassed by unnecessarily disclosing their intimate business affairs."¹⁴⁸ Moreover, Thompson seemed prepared to allow Philip to go on something of a fishing expedition, for he held that, because the plaintiffs were suing on behalf of the company in a derivative action, they were entitled to inspect the company's books and records for "all information necessary to arrive at the material fact."¹⁴⁹

In this discovery context, then, Thompson was attempting to strike a balance between the needs for managerial autonomy and corporate legitimacy: he wanted to protect Du Pont's and the

143. *See id.* at 459-60.

144. *See id.* at 460-61.

145. *Id.* at 462.

146. *Id.* at 463. *See also id.* at 459-60.

147. *Id.* at 463.

148. *Id.* at 464.

149. *Id.* at 463.

banks' corporate privacy as much as possible, but not at the expense of imposing so many procedural barriers on the plaintiffs as to make it impossible for them to prove a manager's abuse of power. Thompson believed that by allowing examination of the books he would be permitting the plaintiffs enough leeway to find evidence, if it existed, to support their allegations that, (1) Pierre and his associates wrongfully had used their corporate positions to reward banks which loaned them the money to purchase Coleman's stock, and (2) that, contrary to the claims of Pierre, the company had sufficient funds in its treasury to have purchased Coleman's stock.

c. *Du Pont v Du Pont II*

Thompson sought to strike a similar balance when he finally ruled on the merits of the case.¹⁵⁰ He first appeared to move in the direction of implementing "corporate legitimacy" by holding Pierre to the strict duty of a fiduciary. A corporate officer's fiduciary duty, Thompson stated,

requires him to exercise the utmost good faith in managing the business affairs of the company with a view to promote, not his own interests, but the common interests, and he cannot directly or indirectly derive any personal benefit or advantage by reason of his position distinct from the coshareholders.¹⁵¹

If the officer obtained any personal advantage in a transaction where his personal interest was in conflict with the corporation's interest, said Thompson, "the law holds the transaction constructively fraudulent and voidable at the election of the corporation."¹⁵² Thompson's comments on corporate officers' fiduciary duties made *Du Pont* a leading case in corporation law.

Thompson applied his fiduciary standard to Pierre's conduct and held that Pierre had breached his duties, first by failing to inform the finance committee of Coleman's belief that the stock Pierre was offering for \$160 was worth \$200, and second by failing to keep negotiations going with Coleman by informing him that

150. *Du Pont v. Du Pont*, 242 F. 98 (D. Del. 1917).

151. *Id.* at 136.

152. *Id.*

the finance committee did not wish to terminate negotiations with its \$125 counteroffer.¹⁵³ Regarding Coleman's opinion of the worth of the stock, Thompson believed that an officer such as Pierre was under a duty of full disclosure of all facts which might inure to the benefit of the corporation¹⁵⁴ and that, if all of the members of the corporation's finance committee knew of Coleman's optimistic evaluation of company prospects, they might have voted to buy the shares at \$160. It appears, however, that to hold Pierre to such a duty of disclosure was to put form over substance because the other members of the finance committee were fully aware of the prospect of profits arising from the company's war contracts upon which Coleman based his optimistic evaluation. Evaluating the same information, it was clear that Alfred and, by implication, William still believed the stock was worth only \$125.¹⁵⁵

Judge Thompson had another basis besides a fiduciary's duty of disclosure for his holding that Pierre was under a duty to continue negotiations, namely, the language of the finance committee's report to the directors, which stated that Pierre was directed "to take the matter up with Mr. T.C. Du Pont further" after communicating the \$125 counteroffer.¹⁵⁶ Nonetheless, in order to reach this conclusion Thompson had to dismiss as incomplete the minutes of the finance committee's December 24 meeting, which were signed by all members and which suggest that Pierre was not under a duty to continue negotiations.¹⁵⁷ On the existence of Pierre's duty to continue negotiating, then, there was an adequate factual basis to reach a conclusion either way. It seems fair to speculate that Thompson's interest in imposing high standards on corporate directors tipped the balance,¹⁵⁸ especially in light of the fact

153. See *id.* at 135, 137.

154. *Id.* at 136. Judge Thompson stated, "By assuming the office, [an officer] undertakes to give his best judgment in the interest of the corporation in all matters in which he is acting for it untrammelled by hostile interest in himself or others." *Id.*

155. *Du Pont v. Du Pont*, 256 F. 129, 150-51 (3d Cir. 1919), *modifying* 251 F. 937 (D. Del. 1918), *cert. denied*, 250 U.S. 642 (1919). See also A. CHANDLER & S. SALSURY, *supra* note 115, at 329-30.

156. See text accompanying note 134 *supra*. This fact is not noted in the account of the case in A. CHANDLER & S. SALSURY, *supra* note 115, which concludes that Judge Thompson incorrectly accepted Alfred's version of events.

157. See text accompanying note 133 *supra*.

158. For other Thompson opinions, which seem to suggest a sensitivity of a need to cir-

that Thompson believed that "Coleman's conclusion to withdraw the offer"¹⁵⁹ was reached by Pierre's allegedly misleading Coleman as to the real action of the finance committee.¹⁶⁰

Thompson also ruled that Pierre fraudulently used his position at the company to secure the \$8.5 million loan,¹⁶¹ despite the testimony of several bank presidents that they had participated in the loan simply because of the *personal* worth of the participants in the holding company and the value of the collateral offered.¹⁶² In the course of his opinion, Thompson in effect found Pierre to be a man without principle who was prepared to sacrifice his relatives to acquire control of Du Pont.¹⁶³ Thompson then held that the company, if it so desired, should be permitted to purchase Coleman's stock from Pierre's holding company, Du Pont Securities, at the price of \$200 per share.¹⁶⁴

Thompson's formulation of a demanding standard of fiduciary care, his strict application of that standard against Pierre, and his denunciation of Pierre's conduct might have been calculated, as was Bradford's opinion in *Jones v. Mutual Fidelity Co.*, to demonstrate to the public that the federal district court unflinchingly would intervene in corporate decisionmaking when confronted with clear evidence of wrongdoing committed by corporate officers. In addition, Thompson suggested that he would not ease the standard

cumscribe the activities of corporations and corporate managers, particularly in the interest of creditors, see, for example, *Gibbon v. Hill*, 79 F.2d 289 (3d Cir. 1935), and *Wheeler v. Badenhause*, 260 F. 991 (E.D. Pa. 1919). Nonetheless, as suggested earlier, there is evidence that Thompson recognized that corporate managers needed substantial autonomy with which to operate, and he would not grant relief to shareholders who alleged misconduct on the part of directors unless the shareholders clearly specified the alleged fraud, collusion, or want of good faith. *Hutchinson v. Philadelphia & G.S.S. Co.*, 216 F. 795 (E.D. Pa. 1914).

159. *Du Pont v. Du Pont*, 242 F. at 137.

160. *Id.* Thompson observed:

The finance committee was in favor of purchasing the stock, but that fact and the reasons for not buying it at \$160 had not been stated to Coleman, although it was rapidly rising in value and Coleman, knowing this, was kept by Pierre in ignorance of facts which Pierre should have disclosed to him.

Id.

161. See *id.* at 122.

162. See generally *id.* at 119-22.

163. Cf. M. DUKE, *THE DU PONTS: PORTRAYAL OF A DYNASTY* 290 (1976). For contemporary newspaper reports that support this interpretation of Thompson's opinion, see N.Y. Times, Sept. 16, 1917, § 2, at 2-3; *id.* Apr. 13, 1917, § 1, at 4.

164. *Du Pont v. Du Pont*, 242 F. at 137-38.

of fiduciary care through exceptions or narrow interpretations, but rather would hold constructively fraudulent any benefit accruing to an officer in a conflict-of-interest situation.¹⁶⁵ Thompson's fervency against the abuse of power in *Du Pont* can be understood to promote corporate legitimacy by demonstrating to the public that, notwithstanding liberalized incorporation statutes, the federal courts stood ready to prevent officers from reaping personal profits at the expense of stockholders.¹⁶⁶

Although Thompson sought to enhance corporate legitimacy by formulating a demanding standard of fiduciary care, he still managed to enhance corporate autonomy by broadly construing the power given to *Du Pont* in its charter.¹⁶⁷ Thompson had to construe corporate powers broadly to hold Pierre accountable for his conduct because Pierre had defended his holding company's purchase of Coleman's stock, *inter alia*, on the ground that *Du Pont* did not have sufficient capital surplus on hand lawfully to purchase Coleman's stock.¹⁶⁸ In order to understand this aspect of Thompson's opinion it is necessary to elaborate on still another facet of the machinations that led up to the litigation. When Pierre's cousin Alfred first learned about the holding company's purchase of Coleman's stock, Alfred had demanded that Pierre turn the stock over to the *Du Pont* company.¹⁶⁹ Pierre at first refused, but then thought better of it and at a meeting of the board of directors held March 6, 1915, offered the stock to the *Du Pont* corporation at the \$200 per share his holding company had paid.¹⁷⁰ Counsel to the corporation, John P. Laffey, advised the board that the stock purchase would be illegal because there was not enough

165. See note 152 & accompanying text *supra*.

166. Thompson also apparently sought to ensure that stockholders would not be deprived of any limited liability which might have had the effect of encouraging investment. See *Grier v. Union Nat'l Life Ins. Co.*, 217 F. 287 (E.D. Pa. 1914). Thus, while Thompson sought to maintain standards of fiduciary care, his willingness to limit shareholders' liability in *Grier*, an ambiguous case, suggests that Thompson's primary goal may have been the maintenance of a healthy market for stock subscription because of the general benefits which would accrue in a smoothly functioning investment environment.

167. Cf. note 158 *supra* (Thompson willing to circumscribe corporate activities, but only if shareholders clearly specified the alleged misconduct).

168. *Du Pont v. Du Pont*, 242 F. at 129.

169. *Id.* at 123.

170. *Id.* at 125.

capital surplus to cover it.¹⁷¹ There is nothing to suggest that Laffey did not believe in the legal advice he offered, although it was clear that Laffey was acting on Pierre's suggestion.¹⁷² Four days later the board rejected Pierre's offer and, before adjournment, elected Laffey a director.¹⁷³

Perhaps this series of events led Judge Thompson to believe that Laffey's advice was not free from self-interest; Thompson clearly disagreed with Laffey's and Pierre's construction of the company's charter provision. He held that the charter provision, which permitted such purchases to be made with sums set aside out of surplus, did not "exclude the use of other funds of the company in making such purchases."¹⁷⁴ So long as the company did not diminish its liquid assets to the point where its creditors were endangered, Thompson said, it could have used any liquid assets on hand to purchase Coleman's stock.¹⁷⁵ The company's current liquid assets exceeded \$33 million, and Thompson found that it had "ample assets on hand out of which it could lawfully have paid for the stock without depleting its paid-in capital."¹⁷⁶

Thompson cited no authority to support his conclusion, reached implicitly, that Pierre and the corporation's board could not rely on the construction of the difficult legal question reached by the corporation's counsel, Mr. Laffey. Perhaps sensitive to this difficulty and to the possible charge that he acted on the basis of a perception that Laffey was not rendering objective advice, Thompson finally decided to limit his intervention in Du Pont's decision-making to the measures least intrusive of corporate autonomy.

Plaintiffs Philip and Alfred requested Thompson to order the immediate sale of Coleman's stock to the company without the formality of a stockholders' vote authorizing the company to purchase the stock. Philip and Alfred argued that Pierre's holding company would have had to account to the Du Pont company for the spectacular dividends it had earned on Coleman's stock, and the com-

171. *Id.*

172. Pierre had consulted Laffey earlier. *Id.* at 123-24. It was Pierre who summoned Laffey to the board of directors' meeting. *Id.* at 125.

173. A. CHANDLER & S. SALSBUURY, *supra* note 115, at 341.

174. *Du Pont v. Du Pont*, 242 F at 132.

175. *See id.* at 133-34.

176. *Id.* at 134.

pany then would have been in a position to use those dividends to purchase Coleman's stock without expending any of its own assets. Further, the sale would have been an extremely profitable bargain for Du Pont:¹⁷⁷ the company could have acquired the stock at a court-ordered rate of \$200 per share at a time when the company's wartime activities had raised the market price to \$900 per share. No stockholder in his right mind, Philip and Alfred argued, would reject such a bargain. Consequently, they urged that there was no need to take the matter up with the stockholders; rather, they prayed that Thompson simply order that the transfer of stock take place.¹⁷⁸

Judge Thompson, however, refused to order the transfer of stock without a stockholders' vote on the ground that "that question of business policy is not one for the determination of the court."¹⁷⁹ Even though it was "a foregone conclusion that its acquisition would be of enormous profit to the company,"¹⁸⁰ the stock had to remain temporarily in the possession of Pierre's holding company because Thompson refused to substitute his judgment for that of the corporation in a matter of business policy. Thompson realized that such a decision normally was made by the board of directors of Du Pont, but because the board was controlled by Pierre and a majority of the board had an interest in Coleman's stock through its participation in Du Pont Securities Company, Thompson ordered that the shareholders vote.¹⁸¹ To guarantee the fairness of the procedure, Thompson ordered that a special master supervise the vote.¹⁸² In addition, Thompson barred Pierre from voting the shares purchased from Coleman, although Pierre was allowed to vote his own substantial block of stock.¹⁸³

177. See *Du Pont v. Du Pont*, 256 F. 129, 185 (3d Cir. 1919).

178. *Du Pont v. Du Pont*, 251 F. 937, 941-42 (D. Del. 1918).

179. *Du Pont v. Du Pont*, 242 F. at 137.

180. *Id.*

181. *Id.*

182. *Id.*

183. In affirming the eventual results of the shareholder vote, Thompson rationalized his refusal to bar Pierre from voting his own stock on the ground that the "court cannot deprive one who is interested adversely to the alleged interests of the corporation and other stockholders from exercising his right to vote his stock." *Du Pont v. Du Pont*, 251 F. at 945.

d. *The Aftermath: Du Pont v Du Pont III*

Pierre appears to have been deeply hurt by Thompson's assertions that Pierre had committed fraud and breached his fiduciary duties. To demonstrate that he sought little profit for himself from his participation in Coleman's sale of stock, Pierre promised that if the shareholders' vote went against him, he would compensate his colleagues in the Du Pont Securities company¹⁸⁴ for the loss of their shares by transferring stock to them from his personal, original holdings in Du Pont. Pierre believed that his colleagues deserved to be compensated because they were the managers who so dramatically had increased the company's earnings.¹⁸⁵ Whatever the eventual outcome, Pierre apparently believed that he might lose the crucial shareholder vote because of the allegations of fraud against him and because of some other possible legal battles.¹⁸⁶

Still, Pierre won the shareholder's vote, 312,587 to 157,959.¹⁸⁷ Judge Thompson then refused to reverse the stockholders' decision,¹⁸⁸ despite allegations that Pierre or his associates had unduly influenced a number of stockholders.¹⁸⁹ "The question of influence exerted upon other stockholders," Thompson stated, "would involve an inquiry by the court into the motives which actuated each stockholder in depositing his vote which it is beyond the power or policy of the courts to pursue."¹⁹⁰

Thompson's refusal to overrule the stockholders where they had implicitly approved what Thompson had decreed to be an abuse of power by one of Du Pont's executives indicates the high premium that Thompson placed on maximum freedom for the exercise of corporate business judgments. In particular, Thompson stated that a reasonable shareholder might have wished to vote in accordance with Pierre's desires in order to keep Pierre, and the same management team that recently had done so well, in control.¹⁹¹

Taken together, Thompson's three *Du Pont* decisions seem to be

184. See text accompanying note 136 *supra*.

185. *Id.*

186. See generally A. CHANDLER & S. SALSURY, *supra* note 115, at 350-52.

187. *Du Pont v. Du Pont*, 251 F. 937, 938.

188. See *id.* at 946.

189. See *id.* at 939-40.

190. *Id.* at 945.

191. *Id.* at 943.

an attempt to strike an appropriate balance between legitimacy and autonomy. Thompson served the legitimizing function by formulating a strict fiduciary duty and finding Pierre guilty of fraud, but Thompson also preserved corporate autonomy, while ostensibly implementing shareholder democracy, by leaving it up to the shareholders of Du Pont, if they desired, to rectify the results of Pierre's wrongdoing.

The Morris Period: Maintaining the Balance

1. Eagleson, Atlantic Refining, Myers, and Hodgman: *Restraining Interference but Preventing Abuses*

a. Eagleson, Atlantic Refining, and Meyers

The Delaware federal district court continued to emphasize the availability of democratic restraints on management after Hugh Martin Morris was appointed in 1918. Morris's willingness to check the abuse of power, suggested by his comments regarding Pierre S. Du Pont,¹⁹² is illustrated by his decision in *Eagleson v. Pacific Timber Co.*¹⁹³ In *Eagleson*, revolution in Mexico had rendered Pacific Timber's property in that country virtually worthless, driving the corporation into insolvency.¹⁹⁴ Pacific devised a reorganization plan whereby all the assets of the old corporation would be transferred to a new one.¹⁹⁵ Those holding common stock in Pacific could exchange their stock for an equal number of shares in the new corporation.¹⁹⁶ Holders of preferred stock also were allowed to exchange their stock for preferred stock in the new corporation, but only if they paid \$10 per share for preferred stock they sought to acquire.¹⁹⁷ Preferred stock in the new corporation also was available to the public at \$10 per share.¹⁹⁸ Shareholders who held both common and preferred stock in the original corporation could not participate in the exchange plan for common stockholders unless they purchased an amount of preferred stock in the new corpora-

192. See text accompanying note 45 *supra*.

193. 270 F. 1008 (D. Del. 1920).

194. *Id.* at 1009.

195. *Id.*

196. *Id.*

197. *Id.*

198. *Id.* at 1010.

tion equal to the amount they held in the original corporation.¹⁹⁹ Eagleson, a holder of common and preferred stock in Pacific, challenged the reorganization plan²⁰⁰ on the ground that he was not being treated equally with other common stockholders.

Judge Morris held that, by effectively denying preferred stockholders the privilege of participating in the exchange plan, Pacific ignored the preemptive rights preferred stockholders were supposed to enjoy over common stockholders,²⁰¹ as "the effect of the reorganization plan was the complete forfeiture of the preferred stock."²⁰² Morris thus insisted that Pacific adhere to the spirit of its original charter provisions²⁰³ even though the reorganization plan was passed by majority vote²⁰⁴ and the plaintiffs had made no specific suggestion of deception on the part of management.

The right to participate in the new corporation, Morris stated, "must be equally favorable to all stockholders of the same class, and a denial of such equality of opportunity is a legal fraud upon the stockholders thus discriminated against."²⁰⁵ Morris found that the plan imposed a disproportionate burden on stockholders who held both common and preferred stock,²⁰⁶ and because few common stockholders fell into this category,²⁰⁷ obviously "the plan of reorganization was for the benefit of the majority, to the detriment of the minority, and consequently unfair and fraudulent."²⁰⁸ Morris followed a long line of authority that demanded equal rights for similarly-situated shareholders and was thus prepared to undermine corporate autonomy to the extent necessary to protect minority rights.²⁰⁹

Morris was unwilling, however, to place great restraints on corporate management. Morris often used procedural requirements to strike the balance between managerial autonomy and corporate de-

199. *Id.*

200. *Id.*

201. *Id.*

202. *Id.*

203. *See id.* at 1011.

204. *Id.* at 1009.

205. *Id.*

206. *See id.* at 1011.

207. *See id.*

208. *Id.*

209. *Id.* at 1010.

mocracy *Atlantic Refining Co. v. Port Lobos Petroleum Corp.*²¹⁰ best illustrates Morris's procedural balance. In *Atlantic Refining*, Port Lobos contracted with Atlantic to sell all the oil it produced in consideration for Atlantic's loan for the construction of pipelines.²¹¹ A breach of contract suit arose from a dispute as to the amount of oil the contract obligated Port Lobos to supply to Atlantic.²¹² Denis, a stockholder of Port Lobos, petitioned for leave to intervene in the case on Port Lobos's behalf on the ground that Port Lobos was so closely connected with Atlantic that it could not present an adequate defense, and that the inadequacy of the defense would damage Port Lobos's minority shareholders.²¹³ Denis alleged that Atlantic owned a majority of Port Lobos's stock and designated a majority of Port Lobos's board of directors from "persons directly connected with or controlled by [Atlantic]."²¹⁴

Judge Morris had to decide when to permit a stockholder of a defendant corporation to intervene as a party defendant.²¹⁵ The issue was within the court's equitable discretion and an issue of first impression in the Delaware district court.²¹⁶ Judge Morris dismissed Denis's petition on the ground that Denis alleged no specific facts to support the charge that Port Lobos was acting against the interests of its minority stockholders.²¹⁷ "A petition founded upon fraud or misconduct," Morris stated, "which does not allege definite, tangible facts to sustain the general charge of fraud, is insufficient and cannot be sustained."²¹⁸ Denis had to do more than allege that Atlantic and Port Lobos entered into a collusive suit to defraud Port Lobos's stockholders. In essence, Morris imposed two procedural hurdles to a successful intervenor alleging collusion: Denis had to show Port Lobos's unwillingness to defend itself²¹⁹ and his own ability to present a viable defense.²²⁰

210. 280 F. 934 (D. Del. 1922).

211. See *id.* at 936.

212. See *id.*

213. See generally *id.* at 936-37.

214. *Id.* at 937.

215. *Id.* at 939.

216. See *id.* at 937.

217. *Id.* at 940.

218. *Id.* at 939.

219. See *id.* Morris stated:

Where it is alleged that the directors of a defendant corporation refuse to de-

Although Morris formulated strict procedural requirements for intervention by a stockholder, there was no objection to Denis's right to amend his petition,²²¹ and Morris gave Denis leave to amend his petition to meet the procedural requirements.²²² In addition, Morris enhanced Denis's right to intervene by holding that, in making the decision on the appropriateness of the intervention, the court would assume that the petitioner's allegations were true without requiring supporting affidavits.²²³

Morris's refusal to close the doors on Denis's petition ultimately redounded to Denis's favor. In a later opinion in *Atlantic Refining*,²²⁴ Morris held that Denis finally had alleged sufficient facts for Morris to allow intervention in the case.²²⁵ This time, Denis included a long list of specific allegations in his amended petition.²²⁶ Not only did Atlantic have a controlling interest in Port Lobos, Denis maintained, but Port Lobos had been reorganized to merge with one of Atlantic's subsidiaries.²²⁷ Denis further alleged that the reorganized Port Lobos had assumed the obligation under the old contract to sell Atlantic its oil even though it was under no legal compulsion to do so,²²⁸ that the sale of all its oil at the contract rate of twenty-five cents per barrel was ruinous to Port Lobos,²²⁹

fend a suit to the prejudice of stockholders, a court of equity will permit one or more stockholders to intervene and become parties defendant, so as to file an answer, not for the corporation, but on their own behalf, to protect their own interest, and that of all other stockholders who may choose to join them in the defense.

Id. (citations omitted).

220. *See id.* at 940.

A petition by a stockholder, asking leave to be made a party defendant to set up a defense not made by the corporation, must disclose the facts constituting the defense; otherwise, the court has no means of knowing whether the defense, if permitted to be made, would be other than frivolous.

Id.

221. *Atlantic Ref. Co. v. Port Lobos Petroleum Corp.*, 283 F 681, 682 (D. Del. 1922).

222. *Id.* at 683.

223. *See Atlantic Ref. Co. v. Port Lobos Petroleum Corp.*, 280 F. at 938-39; 283 F. at 682-83.

224. *Atlantic Ref. Co. v. Port Lobos Petroleum Corp.*, 283 F at 681.

225. *See id.* at 682-83.

226. *See id.* at 681-82.

227. *Id.* at 681.

228. *See id.* at 682.

229. *Id.* at 681.

and that Port Lobos had assumed these obligations over the objections of its minority stockholders.²³⁰ Once these alleged facts met Morris's standards, then he appeared willing to allow intervention.

Despite Morris's decision to allow intervention in *Atlantic Refining*, Morris was not eager to push the equitable powers of his court to the limits to guard against managerial or majority stockholder wrongdoing. In *Meyers v. Occidental Oil Corp.*,²³¹ plaintiff Meyers alleged that defendant Occidental Corporation was insolvent, that Occidental had unlawfully issued stock to its officers, and that the officers had converted the assets of the corporation to their own use.²³² Meyers petitioned the court to appoint a receiver to sell Occidental's assets,²³³ to distribute the proceeds of the sale to the shareholders,²³⁴ and to cancel the allegedly unlawfully issued stock.²³⁵

Meyers sought relief under the same Delaware receivership statute that Judge Bradford, in *Jones v. Mutual Fidelity Co.*, boldly had held applicable in federal court proceedings.²³⁶ Meyers alleged that the insolvency was the result of fraud, but did not offer proof.²³⁷ Further, Meyers advanced no authority to support the proposition that the equitable relief he sought could be granted by a federal court without a statutory provision, although he did argue that a statute was not necessary since one statute, that of Louisiana, was simply "declaratory of pre-existing equitable rights."²³⁸ Morris rejected the notion that such equitable powers existed for his court.²³⁹ Morris declared that he could not appoint a receiver without proof of insolvency because "the appointment of a receiver is merely a remedy incidental and ancillary to the primary object of litigation, and cannot itself constitute such primary object."²⁴⁰ In this manner, Morris appears to have rejected the means of regu-

230. *See id.* at 682.

231. 288 F 997 (D. Del. 1923).

232. *Id.*

233. *Id.* at 998.

234. *See id.*

235. *Id.* at 999.

236. *See text accompanying notes 56-79 supra.*

237. 288 F at 999.

238. *Myers v. Occidental Oil Corp.*, 288 F at 1002.

239. *Id.*

240. *Id.* at 1001.

lating corporations embraced by Judge Bradford,²⁴¹ and thus he limited the interventionary powers of his own court. In this manner he might be seen to have attempted to protect corporate autonomy against novel remedies sought by dissatisfied stockholders.

Nonetheless, as was true in *Atlantic Refining*, Morris did not want to make a judicial remedy totally inaccessible to stockholders. Meyers chose not to sue the officers,²⁴² perhaps because they were not residents of Delaware and service upon them would have been difficult. Judge Morris offered alternative means of bringing the officers to account for their abuse of power. Morris observed that shares in a corporation's capital stock were personal property having their situs in the incorporating state,²⁴³ and a suit seeking the cancellation of stock unlawfully issued by a Delaware corporation "may be brought in this district and service had . . . on defendants residing elsewhere."²⁴⁴ Morris indicated that his court also could assert in rem jurisdiction over corporate assets unlawfully converted by officers if those assets were located in Delaware.

Judge Morris appears to have believed in the importance of maintaining the viability of litigation as a means of correcting corporate wrongs, and thus he may have tried to lower some procedural barriers that otherwise might have impeded stockholder litigation. Morris realized, however, that totally lax procedural standards might lead to harassment of corporations by dissatisfied stockholders filing frivolous suits. For example, Morris's strict pleading requirements enhanced corporate autonomy by allowing corporations with closely connected directorates to do business with minimal fear of frivolous suits by disenchanted stockholders. Morris stressed that it was *not* impermissible for such corporations to do business with each other.²⁴⁵ Morris solved the problem by subjecting stockholder-litigants to strict pleading standards when they alleged corporate wrongdoing. At the same time, he provided procedural alternatives to stockholder-litigants when the strict pleading requirements threatened to prevent litigation and thus

241. See note 236 *supra*.

242. See 288 F at 998.

243. *Id.* at 1003.

244. *Id.*

245. In *Myers*, Judge Morris expressly recognized that "corporations controlled and managed by the same officers and stockholders have a right to deal with each other." *Id.* at 939.

deprive his court of an opportunity to prevent the abuse of power. As was true with the opinions of Bradford and Thompson, then, Morris's procedural decisions in *Meyers* and *Atlantic Refining* seem to represent an attempt to strike a balance, to generate a level of stockholder litigation sufficient to allow the court to serve its legitimizing function but without encouraging so much litigation that desirable corporate activities would be undermined.

b. *The Hodgman Case*

In *Hodgman v. Atlantic Refining Co.*²⁴⁶ Morris once again was called upon to protect stockholders from the alleged abuse of power by corporate managers. In *Hodgman*, Atlantic Refining Company and Superior Oil Company agreed that Atlantic would cancel a \$2.5 million debt owed by Superior if Superior would transfer to Atlantic 325,000 shares of Superior's common stock, enabling Atlantic to acquire Superior's stock at approximately \$8 per share.²⁴⁷ A roughly contemporaneous arrangement that may have been part of the deal obligated Atlantic to buy all of Superior's oil output for ten years.²⁴⁸ At the same time, Superior completed other financing arrangements with a syndicate of underwriters, who had negotiated to purchase other shares of Superior for \$16 per share, and eventually sold those shares to the public for about \$19 per share.²⁴⁹ Finally, during this period Old Dominion Oil Company had conveyed land to Superior in exchange for still other shares of Superior's stock at a rate of about \$16 per share.²⁵⁰

The president of Superior, Robert M. Catts, received 45,000 shares of Superior, apparently as compensation for closing the deal with Atlantic Refining.²⁵¹ The evidence established that Catts intentionally misrepresented the price paid by Atlantic for Superior's shares, both to Superior's board of directors and to the underwriters who were buying shares at \$16 per share,²⁵² leading

246. 300 F. 590 (D. Del. 1924), *rev'd*, 13 F.2d 781 (3d Cir.), *cert. denied*, 273 U.S. 731 (1926).

247. *Id.* at 591.

248. *Id.* at 592.

249. *See id.* at 591.

250. *Id.*

251. *Id.* at 595.

252. *Id.* at 596-98.

Superior's board of directors and the underwriters to believe that Atlantic was paying \$16 per share.²⁵³ While the misrepresentations were being made to Superior's board, E.J. Henry, an officer of Atlantic who sat on Superior's board, remained silent, though he knew that Atlantic was in effect paying \$8, not \$16, per share.²⁵⁴ It appears that the underwriters eventually found out about the misrepresentation but raised no objection. The plaintiff, a minority shareholder in Superior, alleged that the sale of Superior stock to Atlantic was fraudulent and requested that the sale be set aside.

Judge Morris declared that the sale of Superior shares to Atlantic was "consistent with no hypothesis other than that of deliberate fraud."²⁵⁵ He reached this conclusion not only on the basis of the discrepancy in the prices between the sales to Atlantic and to the underwriters, but because the discrepancy was accompanied by false statements made by Catts to Superior's board of directors and to the underwriters.²⁵⁶ Morris declared that the position of the president of a corporation was "fiduciary to a high degree," and that

[o]ccupying such a position of trust, honesty and fair dealing, as well as the law, require that in transactions with the corporation in which transactions the president or director has a personal interest, there must be the fullest disclosure, the utmost good faith, and no secret profits inuring to the officer or director from the transaction.²⁵⁷

Judge Morris found that Catts had made misrepresentations,²⁵⁸ and had profited personally²⁵⁹ by receiving 45,000 shares of Superior stock. Consequently, Judge Morris ruled that the sale of stock to Atlantic was fraudulent²⁶⁰ and set the sale aside. Further, Morris reasoned, Atlantic was equally guilty of the fraud because its officer, Henry, had knowledge of misrepresentations made to Supe-

253. *Id.*

254. *Id.* at 596.

255. *Id.* at 598.

256. *See id.* at 595-98.

257. *Id.* at 594.

258. *Id.* at 591.

259. *See id.* at 594.

260. *Id.* at 598.

rior's board and to its stockholders,²⁶¹ and because Atlantic also knew about misrepresentations to the syndicate of underwriters.²⁶²

Morris granted relief against Atlantic, and it appears that his desire to discourage corporate fraud led him to formulate a creative remedy. By the time Morris decided the liability issue, the market value of Superior's stock had dropped to \$4 per share.²⁶³ The usual remedy in such a case would have been rescission of the contract with a refund of Atlantic's money.²⁶⁴ This remedy, however, would have entailed a transfer of wealth from Superior's stockholders to one of the guilty parties, Atlantic. To prevent Atlantic's unjust enrichment, Morris ordered Atlantic to pay Superior \$2.5 million, the difference between the amount actually paid to Superior and the amount Atlantic would have paid if the price had been \$16 per share.²⁶⁵ Borrowing from the law of contracts, Judge Morris thus sought to do equity where the tort remedy would reward a wrongdoer.²⁶⁶ Atlantic and the miscreant managers had to be punished for their abuse of power; apparently the loss Atlantic suffered from the decreasing market value of Superior's stock was insufficient retribution.

The Nields Period: Preserving the Balance

Several corporations cases decided by Judge John P. Nields, appointed in 1930 to replace Judge Morris, establish Nields's commitment to preserving the balance between managerial autonomy and corporate democracy. *Mallery v. Managers' Securities Co.*²⁶⁷ arose as a result of an attempt by the majority stockholders in Managers' Securities Company to shift part of a \$25 million debt onto the minority. Managers' had been set up by General Motors in 1923 as a profit-sharing program for its managers. By the time *Mallery* was decided, the company had two stockholder classes.²⁶⁸

261. See *id.* at 596.

262. See *id.* at 596-97.

263. *Id.* at 600.

264. See generally *id.*

265. *Id.*

266. *Id.* at 591.

267. 1 F. Supp. 942 (D. Del. 1932), *rev'd*, 77 F.2d 186 (3d Cir.), *cert. denied*, 296 U.S. 593 (1935).

268. See *id.* at 942.

Pursuant to Managers' charter, class A stockholders, all of whom were then employed by GM, received special dividends from the proceeds of a "5 after 7" contract with GM, which provided that Managers' would receive five percent of GM's net income over a seven percent return on the company's investment.²⁶⁹ Managers' class B stockholders received dividends from 2.25 million shares of GM stock owned by Managers'.²⁷⁰ According to Managers' charter, only current GM executives were entitled to hold class A stock.²⁷¹ At the company's inception, the executives whom GM sought to involve were sold an equal number of class A and class B shares.²⁷² When any of the executives terminated their employment at GM, they were required to allow Managers' to repurchase their class A stock.²⁷³

In 1928, the current class A stockholders approved a program whereby they would forego the dividends from their class A stock in order to enhance Managers' future earning capacity.²⁷⁴ Pursuant to this plan, Managers', after procuring a \$25 million loan from J.P. Morgan & Company,²⁷⁵ purchased additional GM stock²⁷⁶ and began retiring the loan gradually with income from the "5 after 7" contract.²⁷⁷ Had the loan and the extra investment in GM stock not been made, of course, the income from the "5 after 7" contract would have been paid to the class A shareholders.²⁷⁸

Managers' suffered a great loss on their 1928 investment in GM stock because of the 1929 stock market crash.²⁷⁹ The market value of Managers' GM stock plummeted, and the income from the "5 after 7" contract vanished, leaving Managers' with a great debt to Morgan which it could not pay.²⁸⁰ Managers' was forced to dis-

269. *See id.* at 942-43.

270. *See id.* at 943.

271. *See id.*

272. *Id.*

273. *Id.*

274. *Id.* at 944.

275. *Id.*

276. *Id.*

277. *See id.* at 945.

278. *See generally id.*

279. *See id.*

280. *See id.*

solve.²⁸¹ During dissolution, Managers' decided to allocate the J.P. Morgan debt among both the class A and class B stockholders.²⁸² Following this decision, Mallery, a former GM executive who held only class B stock, filed suit.²⁸³ He challenged the dissolution plan on the ground that the class A stockholders, who held a majority interest in the company, were attempting to shift part of the Morgan debt onto the minority stockholders, who held only class B stock.²⁸⁴ Mallery contended that the charter provisions that mandated separate accounts for class A and class B stockholders, and the original plan that the loan would be repaid only from the "5 after 7" contract proceeds, showed that the class A account should absorb the debt.²⁸⁵

Nields struck down Managers' dissolution plan and held for Mallery on the ground that, from the company's beginning, the stockholders intended to keep the class A and class B accounts completely separate.²⁸⁶ The class A account always was separate from the class B account, and "it follows as a necessary legal consequence that the investment of that fund is for the sole account of class A stockholders."²⁸⁷ If the benefits from the 1928 stock purchase would have been enjoyed by class A stockholders alone, the burdens of loss could not be shifted onto the entire company.²⁸⁸ Further, the judge also was impressed with the argument that Managers' charter provided for separate class A surplus and general surplus accounts: "Class A stockholders having agreed with the class B stockholders in and by defendant's charter that the proceeds of the '5 after 7 contract' should constitute a separate fund for the sole benefit of class A stockholders,"²⁸⁹ they could not disregard the charter and avoid in part the burden of the J.P. Morgan debt. Consequently, the Managers' Company could not in effect violate its charter and make the class B stockholders bear part

281. *See id.*

282. *See id.*

283. *See id.* at 942.

284. *See id.* at 945.

285. *Id.*

286. *See id.* at 945-46.

287. *Id.* at 946.

288. *See id.*

289. *Id.*

of the loss arising from the stock purchase. With this reasoning, Nields attempted to protect Managers' minority stockholders against an abuse of power by the majority stockholders when the majority stockholders allocated the burdens of corporate misfortune.

Judge Nields continued to guard against corporate abuses of power in *In re Mississippi Valley Utilities Corp.*²⁹⁰ In *Mississippi Valley*, Nields overturned an adjudication of bankruptcy because Mississippi Valley had failed to adhere to its charter provisions in calling a meeting where the shareholders voted to seek bankruptcy.²⁹¹ The company's failure to give notice of the meeting to all of its stockholders, said Nields, required setting aside the adjudication.²⁹² Nields further insisted on procedural regularity. He set aside the adjudication in spite of a second stockholders' meeting which had satisfied the notice requirement mandated by his court's earlier decree, and which sought to "ratify" the court's bankruptcy adjudication.²⁹³ "The [bankruptcy] adjudication," Nields stated, "is the act of the court. The stockholders and directors can ratify their own acts but cannot ratify and make valid an adjudication of the court upon an invalid petition."²⁹⁴ Nields insisted that the stockholders meet again, in accordance with the charter's notice requirement, and vote to seek another bankruptcy adjudication.²⁹⁵

Nields's glorification of form over substance in *Mississippi Valley* might have been designed as a signal to corporate officers that the federal court in Delaware would not tolerate even procedural irregularities. Many of the procedural requirements included in corporate charters, of course, were intended to protect stockholders from the abuse of power by managers—in short, to ensure that the appearance and reality of corporate democracy would be preserved. Nields's decision thus gave some assurance that the judiciary would stand alert against potential inroads to corporate democracy.

Although careful to guard against corporate abuse of power,

290. 2 F Supp. 995 (D. Del. 1933).

291. See *id.* at 998.

292. *Id.*

293. *Id.*

294. *Id.*

295. *Id.* at 997.

Nields's decision in *Koplar v. Warner Bros. Pictures, Inc.*²⁹⁶ indicates that, like Bradford and Morris, Nields also could exercise self-restraint in interfering with managerial autonomy even when he may have disagreed personally with the results reached by corporate decisionmakers. The *Koplar* case arose from a stockholder's objections to the financial remuneration that Warner Brothers Pictures had conferred on three of its officers, the three brothers Warner.²⁹⁷ Pursuant to a contract of employment entered into in late 1928, Warner Brothers issued 90,000 shares of common stock, then worth \$10,000,000, to the brothers and agreed to pay them \$10,000 a week for their services over the next six years.²⁹⁸ In addition to agreeing to work for the company in return for their salaries, the brothers agreed not to compete with the company.²⁹⁹ In a derivative suit, Koplar challenged this salary agreement on the grounds that, (1) it operated as a fraud on the stockholders, and (2) the stock issued to the brothers was without consideration and therefore illegal under the laws of Delaware.³⁰⁰

Judge Nields held that the salary agreement was neither fraudulent nor illegal. Nields found that it was "perfectly apparent" that "the major consideration for the delivery of the 90,000 shares of common stock was the past and future financial aid of the Warner brothers to the Warner Company."³⁰¹ In leaner times, it appeared, the brothers had given generously their Warner stock to the company to be used to secure financing.³⁰² Nields also found no fraud practiced on the stockholders because they had ratified the agreement at their 1928 meeting,³⁰³ and "[d]uring the years 1929, 1930 and 1931 not a single stockholder voted against the re-election of the Warner slate of directors. Not a single stockholder ever complained of the employment contract so long as the company was

296. 19 F Supp. 173 (D. Del. 1937).

297. *Id.* at 174. In addition to the Warners, another director, Waddill Catchings, received financial remuneration. The plaintiff was most concerned with the activities and liability of the three Warner brothers, as the amended pleadings indicate. *See id.* at 174-75.

298. *Id.* at 175, 180.

299. *Id.* at 180.

300. *See id.* at 175.

301. *Id.* at 181.

302. *See generally id.* at 182.

303. *Id.* at 181-82.

making money”³⁰⁴ Nields did not think it appropriate to intervene on Koplar’s behalf because the salary agreement had been executed in the open, with the knowledge and acquiescence of Warner’s stockholders. A reversal of the stockholders’ decision to support the salary agreement, Nields must have reasoned, would have undermined seriously Warner’s managerial autonomy.

Nields also found that, even if the agreement had been fraudulent, the stockholders already had resolved the dispute through their ratification of a “settlement” of other lawsuits that challenged the employment contract drafted by Warner’s board of directors.³⁰⁵ Pursuant to this settlement, the brothers transferred 100,000 shares of common stock back to the company and surrendered their claim to \$680,000 in back pay, and the company surrendered all claims to the money already earned by the brothers under the agreement.³⁰⁶ Nields, observing that the settlement appeared to be a fair compromise,³⁰⁷ held that the company had satisfactorily dealt with the issues raised by Koplar in his derivative suit and dismissed Koplar’s bill of complaint.³⁰⁸

Nields’s support of the compromise agreement, however, may not have meant that he approved of the brothers’ conduct. Referring to the \$10,000 weekly salaries voted to them by the board of directors on which they sat, Nields stated:

As a matter of morals such payments may be questioned. Directors have the power to award just compensation. That power should be used, not abused. Fair human requirements should set some limits to salaries. Extraordinary talent is not acquired. If it were, it would not be extraordinary. Doubtless it is an endowment which the holder should not place on the auction block.³⁰⁹

Yet, Nields did not allow his opinion of a fair salary to interfere with his determination of the case, but rather let the stockholders

304. *Id.* at 183.

305. *See id.* at 184-85.

306. *Id.* at 185.

307. *Id.*

308. *See generally id.* at 188. Attorneys for Koplar argued that the settlement was invalid because the notice for the 1935 stockholders’ meeting failed to disclose important facts. *Id.* at 186. Nields found, however, that “the stockholders were adequately and sufficiently informed.” *Id.*

309. *Id.* at 188.

decide the salary question for themselves.

Indeed, it appears that Nields's moral scruples against the compensation awarded to the Warner brothers was counterbalanced by his obvious admiration for the brothers' business success prior to the depression. Nields particularly was impressed by the brothers' courage in concocting million-dollar schemes to finance their enterprises, which enabled them to become "pioneers in the 'talkies.'"³¹⁰ Nields wrote of these machinations in seeming awe:

Their plan of financing their business through bank credits instead of advances from franchise holders was a move involving millions. Their acquisition of a great chain of theaters to use their films was a step involving more millions. To keep abreast of the march of time demanded extraordinary and heroic efforts.³¹¹

There are several reasons why Nields was so impressed with the Warner brothers' activities that he spoke of them as "extraordinary" and "heroic," terms which he similarly applied to Theodore Roosevelt and Pierre S. Du Pont.³¹² First, at least until the depression was well underway, the brothers succeeded to earn staggering sums of money through their daring management of the company.³¹³ Nields also may have been impressed that the brothers continued to tie their fortunes to those of the company, even in dark times:

In the fiscal year ending August 31, 1929, the net profits were \$17,271,805. For the six months ending March 1, 1930, the net profits were \$10,092,109. For the fiscal year ending August 30, 1930, the net profits were \$7,074,621, despite the fact that the last half of that fiscal year showed a net operating loss of \$3,000,000. Thereafter as the depression deepened the Company's losses increased. Throughout the depression the Brothers continued to loan the Company substantial amounts.³¹⁴

Finally, Nields must have noticed that the public enjoyed perhaps its most absorbing, if frivolous, diversions from the economic ago-

310. *Id.* at 182.

311. *Id.*

312. See text accompanying notes 47 & 51-52 *supra*.

313. See generally *Koplar v. Warner Bros. Pictures, Inc.*, 19 F Supp. at 182-83.

314. *Id.* at 183.

nies of the depression because the brothers pioneered efforts in developing "talkies." It seems more than coincidental that Judge Nields, who had the habit of sneaking off to the movies at lunch time, appears to have been a devoted fan of "class B cowboy pictures."³¹⁵

Nields's *Koplar* decision, then, may have been calculated to preserve what he believed to be the invaluable benefits of management autonomy by allowing the stockholders' and managers' settlement decision on the Warner brothers' salaries to stand, although Nields's beliefs about his "legitimizing" function may have led him to admonish the Warner brothers for reaping such lavish financial rewards. Nields's *Koplar* decision thus may have suggested to corporate officers that, under his guidance, the district court would hesitate to intrude upon management autonomy unless the corporate decisionmaking process was so defective that no possibility of self-correction existed. In short, Nields's self-restraint may have rested on the corporation's capacity for self-correction.

THE THIRD CIRCUIT: SHIFTING THE BALANCE

Despite the efforts of the Delaware district court to strike a compromising balance between managerial autonomy and corporate democracy, the United States Court of Appeals for the Third Circuit consistently shifted the balance in favor of managerial autonomy. An analysis of *Du Pont*, *Hodgman*, and *Mallery*, three relevant appellate decisions during this period, shows the analytical approach of the Third Circuit in creating this shift, and demonstrates a striking contrast to the opinions of the district court examined above.³¹⁶

Du Pont v Du Pont

After losing the shareholder vote that the district court ordered,³¹⁷ Alfred and Philip Du Pont took their case to the Third

315. Wilmington News-Journal, Dec. 19, 1975, at 12.

316. Compare with what follows the text accompanying notes 114-191 *supra* (*Du Pont*), the text accompanying notes 246-266 *supra* (*Hodgman*), and the text accompanying notes 267-289 *supra* (*Mallery*).

317. See text accompanying notes 179-183 *supra*.

Circuit,³¹⁸ contending that Judge Thompson had erred by failing to order the immediate transfer of Coleman's stock to the Du Pont company. Judge Joseph Buffington, delivering the opinion of the court of appeals, not only held that the shareholders' decision not to purchase Coleman's stock was a matter of business policy beyond the judiciary's purview,³¹⁹ but extensively reevaluated the facts and declared that Pierre had not violated any of his fiduciary duties in participating in the acquisition of Coleman's stock.³²⁰ Buffington held that Pierre was not under a continuing duty to negotiate with Coleman on behalf of the company for the purchase of Coleman's stock because the finance committee had decisively rejected Coleman's offer.³²¹ The court reached this conclusion by relying on both Pierre's interpretation of finance committee events and on the text of the finance committee's minutes.³²² It is noteworthy that Judge Thompson reached an opposite inference as to the facts and that Buffington gave no explanation of the appellate court's assumption of authority to rule on the factual question that was Thompson's province as the trial court judge. Further, the appellate court minimized the importance of the finance committee's report to the board of directors,³²³ suggesting opaquely that the language that directed Pierre to "take the matter up with Mr. T. C. Du Pont further" was simply a "courteous way" of directing Pierre to reject "what Coleman regarded as a generous offer."³²⁴

The Third Circuit's relatively narrow interpretation of Pierre's fiduciary duties as a Du Pont executive and its repeated assertions that Pierre was not guilty of fraud suggest that the court favored the enlargement of management's discretion beyond the range established in the district court by Judge Thompson. Thompson had held that any personal benefit reaped by managers was constructively fraudulent, but the Third Circuit in effect held that managers could pursue actively their own interests. The court appears to

318. *Du Pont v. Du Pont*, 256 F. 129 (3d Cir. 1919), *modifying* 251 F. 937 (D. Del. 1918), *cert. denied*, 250 U.S. 642 (1919).

319. *See id.* at 184.

320. *See id.* at 174.

321. *See id.* at 172.

322. *See* transcripts of testimony and committee minutes, *id.* at 142-74.

323. *See* text accompanying note 156 *supra*.

324. *Du Pont v. Du Pont*, 256 F. at 154-55.

have acknowledged that the finance committee gave vague instructions to Pierre and that the instructions might be construed, in the way Philip and Alfred suggested, to place Pierre under a continuing duty to act for the committee, and not for himself.³²⁵ Nonetheless, the court urged that Pierre was justified in believing that his duty to negotiate on behalf of the company had ended, and Pierre therefore could proceed to act on his own initiative and in his own interest because the instructions *were* vague, and because the other members of the finance committee, who disagreed with Pierre in interpreting the instructions, had several opportunities to reaffirm Pierre's agency on behalf of the finance committee yet chose not to do so.³²⁶

It seems likely that the district court's Judge Thompson was trying to establish some basic mechanisms of stockholder democracy without seriously interfering with corporate autonomy, and it also seems likely that he was writing with the public audience in mind. Nonetheless, the Third Circuit's opinion in *Du Pont*, its long summary of the facts, and its interpretation consistently favorable to Pierre, was probably designed for a somewhat different audience, the corporate managers. Perhaps the Third Circuit wished to reassure the corporate managers that, where they believed themselves to be acting in good faith, in the best interests of their companies, the federal courts would not hamstring them. Apparently, the court of appeals was most impressed that, although Pierre executed his scheme to seize personal control of the company and removed some of his relatives from influential positions, he did so because he believed that the company's situation demanded it.

325. See generally *id.* at 157. The court called the instructions "vague, indefinite, and conditional." *Id.*

326. *Id.* at 157. Judge Buffington's understanding of the corporate director's role seems consistent with human nature, primarily because Buffington understood the difficulty of proceeding under vague instructions. Buffington's construction of the duty of corporate fiduciaries, however, appears to have departed from what currently is recognized as the usual standard of care in corporate opportunity cases. This standard was best articulated by Justice Cardozo, in a case involving "joint adventurers," and his words, in content if not in phrasing, are similar to Judge Thompson's. See text accompanying notes 151-152 *supra*. Cardozo stated that businessmen who bore a fiduciary relationship to each other were to be held "to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is [for them] the standard of behavior." *Meinhard v. Salmon*, 249 N.Y. 458, 464, 164 N.E. 545, 546 (1928).

Some testimony in the case clearly supports this view, though that testimony did not weigh heavily with Judge Thompson.³²⁷

For example, the Third Circuit suggested that both its holding and factual finding were influenced by factors ignored by Thompson, such as Pierre's belief that it was necessary to relieve Coleman of his stockholdings because there was a possibility that Coleman's debt would lead to possession of his stock by pro-German interests, and that rumors circulating to that effect were already threatening to result in the loss of orders and profits for the company.³²⁸ The court also appears to have been impressed that Pierre, through participation in the holding company, used Coleman's stock to reward some of the junior officers at Du Pont, men whom the company wanted to encourage because of their great productivity.³²⁹ Finally, it is probable that the court of appeals may have been influenced by T. Coleman Du Pont's letter to the Du Pont directors and stockholders, written on May 11, 1917, shortly after Judge Thompson ordered a stockholder meeting. In the letter, Coleman claimed that Pierre fully apprised him of the attitude of the finance committee, that the statements of the plaintiffs' attorney to the contrary were "entirely unwarranted and are untrue in every particular," that he never intended to offer more stock to the company than he did in his original rejected offer, and that "the stockholders should know directly from [him] that [he believed] that they have no right or interest whatever in the stock which [he] formerly owned."³³⁰

Hodgman v Atlantic Refining Co.

In addition to modifying Judge Thompson's decision in *Du Pont*, the Third Circuit reversed Judge Morris's opinion in *Hodgman*.³³¹ The Third Circuit's reversal of the district court in *Hodgman* bears a strong resemblance to its reversal of the district court

327. This testimony was printed in the N.Y. Times, Oct. 3, 1917, § 1, at 10, cols. 4-8.

328. *Du Pont v. Du Pont*, 256 F. at 162, 167-69.

329. See text accompanying notes 124-125 & 136 *supra*.

330. See note 327 *supra*. Given the circumstances of the company, it seems understandable, and probably desirable, that the Third Circuit enlarged the ambit of corporate managerial autonomy to legitimize Pierre's actions.

331. *Atlantic Ref. Co. v. Hodgman*, 13 F.2d 781 (3d Cir. 1926), *rev'g* 300 F. 590 (D. Del. 1924), *cert. denied*, 273 U.S. 731 (1926).

in *Du Pont* because both appellate opinions demonstrate a willingness to create great discretion for management and reveal less of an inclination to find fraudulent conduct on the part of managers.

In *Hodgman*, in another opinion written by Judge Buffington, the appellate court declared that it had the benefit of an "enlightening and authoritative"³³² Delaware chancery court decision³³³ which was decided after the district court's opinion was written. The appellate court cited the case for the proposition that when "fairness in light of all the circumstances" dictated that stock should be sold to different persons at different prices, and when such a differential sale was done in the "genuine and beneficial interest of the corporation," no transactions need be set aside.³³⁴ Relying on the above reasoning, the court of appeals declared that the deal struck between Superior and Atlantic should not be set aside for fraud.³³⁵

Even if the Third Circuit relied on authority unavailable to Morris, it is clear that Buffington's analysis concentrated on aspects of the transaction which were of minimal importance to Judge Morris, and minimized those aspects which had disturbed Morris most. For example, Morris appears to have believed that the roughly contemporaneous ten-year purchase contract Atlantic had made with Superior should not have been treated as an element of the stock deal. Morris had observed that, although Atlantic was obligated to buy all of Superior's oil, Atlantic was to buy at market prices, and "[t]he Superior product was of a desirable quality, and usually sold readily at a premium above posted prices."³³⁶ Further, trial testimony showed that "[t]he overbearing element" of Atlantic's decision in making the ten-year arrangement was the refining company's "desire to assure for our refineries for a long period of time the appreciable and staple quantity of crude oil" which Superior could supply.³³⁷ In contrast, the court of appeals declared that the ten-year deal became effective at a time when "oil was at low

332. *Id.* at 788.

333. *Bodell v. General Gas & Elec. Corp.*, 15 Del. Ch. 119, 132 A. 442 (1926).

334. *Atlantic Ref. Co. v. Hodgman*, 13 F.2d at 788 (quoting *Bodell v. General Gas & Elec. Corp.*, 15 Del. Ch. 119, —, 132 A. 442, 448 (1926)).

335. *See id.* at 793-94.

336. *Hodgman v. Atlantic Ref. Co.*, 300 F. at 595.

337. *Id.* at 595.

figures and a drug on the market," so that Atlantic simply was not benefiting from the ten-year obligation.³³⁸ The court emphasized that, despite any misleading information regarding the price paid by Atlantic for Superior stock, the underwriters would not have entered into their stock purchase without the ten-year guaranteed acquisition of Superior's output by Atlantic; the court then concluded that Superior would not have received the \$16 per share it did from the underwriting deal without the sale to Atlantic at the lower price.³³⁹ The court of appeals reasoned that Superior clearly benefited from the sale even at the lower price³⁴⁰ because Superior badly needed the operating capital it received from the underwriting.³⁴¹ Further, the court observed, the underwriting venture would have been impossible unless Atlantic released Superior from its obligations under the original \$2.75 million loan from Atlantic to Superior because the loan contained a condition that no further issuance of stock was permitted until the loan was paid.³⁴² This fact also appears to have been of little importance to Morris.

Similarly of little importance to Morris, but of great moment to the Third Circuit, was that Atlantic obligated itself not to sell any of the shares it received for two years. Buffington commented that this obligation meant that Atlantic benefited Superior

by changing its position of creditor with assured periodic interest payments for that of stockholder with uncertain dividends; by tying up its stock for 2 years as that stock which others, during the tie-up period, sold for \$16, and indeed as high as \$20.75 had only a value of some \$6 when the tie-up expired.³⁴³

Atlantic hardly had profited from this arrangement. Instead, Buffington suggested, Superior benefited, and the entire transaction was within the Superior corporation's "zone of discretion"³⁴⁴ and therefore could not be challenged by a dissident stockholder. Indeed, "there was equal, if not stronger, ground for stockholders of

338. *Atlantic Ref. Co. v. Hodgman*, 13 F.2d at 794.

339. *Id.*

340. *See id.* Bankers were paying \$16 per share for Superior stock; Atlantic purchased the stock for \$8 per share. *Id.* at 789.

341. *Id.* at 788.

342. *Id.*

343. *Id.* at 794.

344. *Id.* at 788.

Atlantic criticizing their company's management for entering into these contracts than for Superior's blaming their management."³⁴⁵

Still, Buffington appears to have sought to have minimized the likelihood of success of any suit by Atlantic shareholders, as he then proceeded, in effect, to overrule Morris's findings of fact and held that, even though Superior's President Catts might have committed fraud, Catts's fraudulent acts "were in no way connected with, participated in, or even known to, Atlantic."³⁴⁶ Buffington acknowledged that Atlantic's officers had followed Catts's instructions not to reveal to the underwriters the price at which Atlantic was buying Superior's stock, even though Atlantic's officers knew Catts was telling the underwriters that Atlantic was paying \$16 per share. Buffington observed, however, that the underwriters were not harmed because they did eventually learn the price Atlantic was paying.³⁴⁷ Perhaps more troublesome to the court of appeals was that Henry, Atlantic's officer, had sat quietly at Superior's board of directors meeting as Catts made incorrect statements about the price that Atlantic would pay for Superior's stock.³⁴⁸

This part of the appellate opinion appears to come very close to, if it does not pass the point of, condoning actual fraud on the part of Henry First, the court declared that Henry denied the fact that he was present when misrepresentations were made as to the price Atlantic was paying and that others' testimony supported Henry.³⁴⁹ Perhaps ultimately refusing to reverse Judge Morris's finding of fact to the contrary, however, Buffington attempted to excuse Henry's conduct by ruling that:

[A]ssuming for present purposes such statements were made, and that Henry, who knew that Atlantic was only paying \$8, remained silent, such silence is not necessarily fraudulent in purpose, for Henry might well have assumed that, as Superior had intrusted the financing plant [sic] to Catts, its president, as Catts was its sole representative in dealing with the bankers and Atlantic, and as Catts had requested Atlantic not to disclose its price, we may as well attribute Henry's silence to his feeling he

345. *Id.*

346. *Id.* at 789.

347. *See id.* at 790-91.

348. *See id.* at 793.

349. *Id.*

was complying with Superior's wishes, expressed by its president, about a sale at different prices, which was lawful, as to evidence a purpose to mislead and defraud.³⁵⁰

This ruling means, then, that the Third Circuit, *per* Buffington, did not necessarily view intentional misleading of other directors or stockholders as fraud, because the misleading might be consistent with the overall business purposes of the corporation. Clearly, Morris reached an opposite conclusion. Morris contended that, where there was intentional misleading in circumstances such as those of *Hodgman*, where the party engaging in the misrepresentations derives financial benefits, the strict standards of fiduciary conduct which Morris believed ought to apply to a corporate officer required that such misrepresentations be found to be fraud.³⁵¹ As did its opinion in *Du Pont*, the Third Circuit's opinion in *Hodgman* loosened fiduciary standards and facilitated the concentration of corporate power in management.

Managers' Securities Co. v Mallery

In 1935, the United States Court of Appeals for the Third Circuit, continuing the trend evident in its *Du Pont* and *Hodgman* opinions, reversed John Niels's decision in *Mallery*.³⁵² In an opinion written by Judge J. Warren Davis, the Third Circuit held that the J.P. Morgan debt had to be borne by the company as a whole, rather than by one class of stockholders,³⁵³ because "money earned by a corporation does not become the property of its stockholders until it is distributed to them as dividends or in dissolution."³⁵⁴ Even though the "5 after 7" income was credited to a separate class A account, Davis wrote, "until it was distributed in dividends or in retiring stock, it remained an asset of the corporation."³⁵⁵ The inescapable corollary that followed from this assertion was that any debt procured through the use of the "5 after 7" income

350. *Id.* at 793-94.

351. See text accompanying notes 257-260 *supra*.

352. *Managers' Sec. Co. v. Mallery*, 77 F.2d 186 (3d Cir. 1935), *rev'g* 1 F. Supp. 942 (D. Del. 1932), *cert. denied*, 296 U.S. 593 (1935); see text accompanying notes 267-289 *supra*.

353. See text accompanying notes 287-289 *supra*.

354. 77 F.2d at 190.

355. *Id.*

had to be borne by the corporation, and not by a single class of stockholders.³⁵⁶

Davis's opinion arrived at this conclusion after first declaring that Managers' 1928 purchase of GM stock violated its charter;³⁵⁷ consequently, the loss arising from the violation had to be borne by the entire corporation, rather than the class A stockholders, because all corporate members had to take responsibility for the corporation's illegal act.³⁵⁸ Judge Davis noted that the charter had provided that the "5 after 7" income was to be used only for retiring class A shares and for paying dividends to class A stockholders. He then reasoned that Managers' had "improperly used the earnings to purchase that stock, and the class A stockholders, as such, may not be held liable for the defendant's illegal acts which directly injured them more than it did any one else."³⁵⁹ The court thus used Managers' charter to enforce the imposition of the J.P. Morgan debt onto the entire company even though only the class A stockholders had stood to gain from the 1928 investment.³⁶⁰ The court's opinion was not without some logic and authority insofar as the opinion rested on the proposition that all stockholders should have borne the responsibility for an ultra vires action.³⁶¹ Nonetheless, the proceeding was one in equity, and it would seem that the district court's Judge Nields possessed equitable discretion to decide that the class A shareholders should have been made to bear the loss because they would have stood to gain the most.

It appears, then, that *Mallery* further illustrates divergent approaches to corporate law pursued by the district court and the court of appeals. Whereas Nields in *Mallery* (and Thompson in *Du Pont*, and Morris in *Hodgman*) sought to "legitimize" corporate autonomy by checking a majority's or a manager's abuse of power, Davis's opinion for the Third Circuit in *Mallery* lent support to a corporation's discretionary use of power by a somewhat strained interpretation of Managers' charter. The company's charter did not explicitly proscribe the use of "5 after 7" income for purchas-

356. See *id.* at 192.

357. *Id.*

358. See *id.*

359. *Id.* at 191.

360. See *id.* at 190, 192.

361. *Id.* at 192.

ing additional stock, but merely stipulated two uses to which the income would be put—the retirement of debts and the payment of dividends.³⁶² The reinvestment plan, after all, was a deferred scheme for the payment of dividends, and if one wished to construe the charter liberally, the reinvestment plan would seem clearly permissible. As was true in these other appeals, Davis's strict interpretation of the charter seems only to have occurred because of a desire not to restrict the discretion of the majority shareholders or the managers.

CONCLUSION

In the first half of this century the American public was both attracted and repelled by corporations. Although many persons in government and business perceived large corporations and economic concentration as necessary concomitants to a mass production economy, public spokesmen decried what they believed to be an alarming accumulation of social and economic power. Americans wanted the goods produced by the highly industrialized economy of the twentieth century, but, as Justice Brandeis observed in *Louis K. Liggett Co. v. Lee*,³⁶³ there was a continued, pervading suspicion "that by the control which the few have exerted through giant corporations, individual initiative and effort are being paralyzed, creative power impaired and human happiness lessened."³⁶⁴

Although there were attempts at regulation, as well as "devil" theories of the corporation and popular fears of its Leviathan-like power, the public and the government's attitude toward corporations from the 1890's to the 1930's is best characterized as one of Janus-faced ambivalence. Government officials and public spokesmen knew, and sometimes maintained, that corporations facilitated increased productivity which brought mass-produced consumer goods to the public, and some advocated corporate managerial autonomy so that productivity might continue.³⁶⁵ De-

362. *Id.* at 189; *see id.* at 192.

363. 288 U.S. 517 (1933).

364. *Id.* at 565 (Brandeis, J., dissenting).

365. At the beginning of this century, according to J. Willard Hurst, "we treated the corporate instrument as so useful for desired economic growth as to warrant using law to make it available on terms most responsive to businessmen's needs or wishes." J. HURST, *supra* note 18, at 62.

spite these opinions, or perhaps as an inescapable corollary, many of these same persons characterized the corporation as a bloodless money-making monster, a menace to the common man, that not only would take away his livelihood but also would corrupt his republic.³⁶⁶ In short, "the use Americans have made of the corporate device [was] strangely at odds with this historic mistrust of corporations and 'Big Business.'"³⁶⁷

The federal judges in Delaware had contradictory and somewhat irreconcilable responsibilities. First, they were required to ensure that the rights of all stockholders were protected against corporate abuse of power.³⁶⁸ The courts seemingly concluded that the protection of a stockholder's rights, especially his right to govern corporate policy by voting his stock, would best confer legitimacy on the corporate autonomy that was newly-created by permissive legislative frameworks.³⁶⁹ Only by maintaining some semblance of "democratic" shareholder control could the courts allay the "vague and indescribable dread and suspicion"³⁷⁰ of corporate plutocracy that gnawed at the public psyche.

The Delaware federal judges also may have realized that their review of corporate decisionmaking, in an exercise to protect stockholder rights, not only would encourage general public acceptance of corporations, but also might make stockholders less fearful of corporate relocation in Delaware, thereby generating more state revenues. When stockholders perceived that there was a judicial, if not a legislative, check against the infringement of their rights in Delaware, they would be more willing to vote in favor of relocation so as to enjoy the advantages of corporate autonomy while avoiding the dangers. Moreover, the federal judges' regulation of corporate activities most likely enhanced the growth of corporate autonomy because growth ultimately depended on public and

366. See, e.g., Grover Cleveland's Address to Congress, 1896, *quoted in* A. THIMM, *BUSINESS IDEOLOGIES IN THE REFORM-PROGRESSIVE ERA: 1880-1914*, at 56 (1976).

367. H. GRAHAM, *EVERYMAN'S CONSTITUTION: HISTORICAL ESSAYS ON THE FOURTEENTH AMENDMENT, THE "CONSPIRACY THEORY", AND AMERICAN CONSTITUTIONALISM* 372 (1968).

368. The Delaware federal district judges believed that part of their judicial task was to ensure that stockholders were not exploited by corrupt managers or crafty "robber barons." A. CONRAD, *CORPORATIONS IN PERSPECTIVE* 30 (1976).

369. J. HURST, *supra* note 13, at 93.

370. W. COOK, *THE CORPORATION PROBLEM* 253 (1893).

stockholder support, which could be better obtained if the exercise of managerial power could be "legitimized."

In addition, the federal judges had a second responsibility—to guard against being so zealous to protect shareholder democracy that they might endanger managerial autonomy and thus discourage incorporation. Perhaps sensing this responsibility, the judges generally refused to intervene in corporate activities when intervention would have interfered substantially with the corporations' abilities to make business decisions.

The Delaware district court reflected public ambivalence toward corporations by attempting to strike a balance between corporate "legitimacy" and managerial autonomy. In their decisions, Judges Bradford, Thompson, Morris, and Nields sought to "legitimize" managerial autonomy, largely created by the Delaware legislature, by maintaining mechanisms of democratic control over corporate decisionmaking and by preventing managers from egregiously abusing corporate power. At the same time, the judges exercised self-restraint to preserve managerial autonomy by limiting their interventionary activities to those instances of clear abuse of power, such as deception, discrimination against minority stockholders, or violation of charter provisions.

This judicial self-restraint, in combination with the broad opportunities that the Delaware legislature gave corporations, facilitated the concentration of economic power in corporate management. With the sharp reduction in the demands that legal and governmental institutions imposed on corporations, the corporations were left relatively free to respond to economic necessities. These economic necessities gave rise to what Alfred O. Chandler has called the "managerial revolution":

Technological innovation, the rapid growth and spread of population, and expanding per capita income made the processes of production and distribution more complex and increased the speed and volume of the flow of materials through them. Existing market mechanisms were often no longer able to coordinate these flows effectively. The new technologies and expanding markets thus created for the first time a need for administrative coordination. To carry out this function entrepreneurs built multiunit business enterprises and hired the managers needed to administer them. As technology became both more complex and more productive, and as markets continued to expand, these

managers assumed command in the central sectors of the American economy.³⁷¹

Delaware district court judges expanded and legitimized managerial autonomy, and thereby helped to ensure that the level of legal restraints on corporations remained low enough to allow managers to ascend in the corporate power structure, as they did, for example, in Delaware's premier industry, the Du Pont corporation.³⁷² With the concentration of corporate power in management, the managers could make production and distribution decisions without significant fear of stockholder interference through judicial machinery. Until about 1937, as long as the managers remained within the limits that the district court judges established to "legitimize" corporate and managerial autonomy, the managers were free to operate their enterprises as they saw fit, notwithstanding individual or group stockholders' objections.³⁷³

The Third Circuit's court of appeals went even further than did the district court in facilitating the concentration of power in management and, particularly in Judge Buffington's *Du Pont* and *Hodgman* opinions,³⁷⁴ appeared to disregard some of the district court's "legitimizing" legal restraints on managerial and corporate power. It is not now possible to determine conclusively what caused the judges of the Third Circuit's court of appeals to depart from the balanced approach of the district court judges. There are suggestions in the biographical details which can be discovered regarding Circuit Judge Buffington, however, that the court of appeals judges simply might have placed more faith in the benefits to be derived from managerial autonomy than did the district court judges. It will be remembered that District Judge Bradford tem-

371. A. CHANDLER, *supra* note 5, at 484.

372. See generally text accompanying notes 114-191 *supra*.

373. Although the professional and familial ties of the Delaware district judges suggest that they would be amenable to corporate interests, the district court decisions do not appear to reflect great bias either for or against corporate autonomy. In fact, the district court often was sympathetic to proponents of fiduciary responsibility. For example, Judge John P. Nields's professional ties would have led some persons to expect that he would support the management in *Mallery*, who argued in favor of spreading the debt to the minority shareholders. Nields instead held in favor of the minority shareholders. Curiously, the willingness to promote fiduciary responsibility appears to have transcended political party loyalties, being as strong in the Republicans, Bradford and Nields, as in the Democrat, Morris.

374. See text accompanying notes 318-351 *supra*.

pered any reverence for corporations with the moral fire of Savanarola,³⁷⁵ that District Judge Morris may have been concerned about the arrogance of corporate plutocrats such as Pierre S. Du Pont,³⁷⁶ and that District Judge Nields, while he may have revered Pierre Du Pont, shared Morris's reservations about what "vast corporate wealth and influence" might do if left unregulated.³⁷⁷ These cautious attitudes, these doubts about what corporations or the wealthy might do if not subject to check, do not appear to have troubled Circuit Judge Buffington.

Judge Joseph Buffington was a fascinating figure. Well known before and during the First World War for his speeches to the European immigrants to Pennsylvania, Buffington seems to have relished his duty to lecture the foreign-born on the duties of American citizenship. Most often in Buffington's statements these duties included sobriety, obedience to the law, and acceptance of existing American social and economic conditions. In 1919, Buffington told a group of new American citizens that "the man who is always kicking about the Government is a domestic enemy, and you should avoid him."³⁷⁸ At this time he made aliens going through the naturalization process recite a special oath which he had composed that they were neither anarchists nor polygamists.³⁷⁹ He appears also to have been particularly wary of "Bolshevism."³⁸⁰ For Buffington there was no need for social reform. "Law and order and love of country sum up our needs,"³⁸¹ he stated in 1919. As a proponent of law and order Buffington was nearly unmatched. He called for stern, unflinching, and vigorous suppression of mob rule,³⁸² and he recommended the whipping post for repeat offenders because "[a] professional criminal who is punished by such an institution as the whipping post is not only punished in his own

375. See text accompanying notes 38-40 *supra*.

376. See text accompanying notes 43-45 *supra*.

377. See text accompanying notes 46-53 *supra*.

378. N.Y. Times, Oct. 1, 1919, § 1, at 2, col. 5; see *id.* Oct. 28, 1919, § 1, at 1.

379. Buffington's oath: "I am not a disbeliever in or opposed to organized Government or a member of or affiliated with any organization or body of persons teaching disbelief in or opposed to organized Government. I am not a polygamist, nor a believer in the practice of polygamy" *Id.* Oct. 1, 1919, § 1, at 2, col. 5.

380. *Id.* Jan. 11, 1919.

381. *Id.* Nov. 2, 1919, § 1, at 22, col. 1.

382. *Id.* June 13, 1920, § 8, at 8, col. 4.

eyes but loses caste with his fellow-criminals.”³⁸³ In 1933, with the close of Prohibition and the advent of the bank “holiday,” Buffington told the immigrants, “Don’t be like some of the younger generation who think it smart to drink a cocktail”; and “Don’t be frightened by what has happened in recent days about banks. There are many, many honest banks and bankers who will take care of your money”³⁸⁴

Judge Buffington, as a good Republican, as a good Episcopalian, and as a man prominent in Philadelphia social circles, in short, as a proper bourgeois, appears to have believed that it would be best for the country to have a relatively submissive working class and orderly development of the American economic system.³⁸⁵ In an opinion in which he declined to hold that the activities of United States Steel violated the Sherman Act, Buffington had made clear his concurrence in the views that “[s]uccess and magnitude of business, the rewards of fair and honorable endeavor, were not among the evils which threatened the public welfare and attracted the attention of Congress.” He appeared to agree with the characterization of a government witness who commented on the “magnificent” and “wonderful” organization which resulted in specialization of the managers of the international operations of United States Steel; he noted approvingly the domestic benefits to be gained by the foreign operations of the company; and he concluded that the United States Steel company’s success was not due to a conspiracy in restraint of trade but rather from the company’s inspired integration of operations and “economy of management.”³⁸⁶ Perhaps Buffington’s decision in the *Du Pont* case³⁸⁷ also illustrates a sympathy for managerial interests and his faith that

383. *Id.* Apr. 6, 1928, at 10, col. 2. When not advocating use of the whipping post, Buffington used moral suasion as a crime prevention device. In 1926, while sentencing a young criminal, Buffington told the offender: “Don’t think you are smart in trying to outwit the law. Crime doesn’t pay; in fact, it is the most stupid thing imaginable.” *Id.* Mar. 13, 1926, at 4, col. 5.

384. *Id.* Mar. 23, 1933, at 2.

385. When advocating the use of the whipping post, for example, the *New York Times* reported that Judge Buffington “was not so much interested in causes back of crime waves as in methods that will check them.” *Id.* Apr. 6, 1928, at 10, col. 2.

386. *United States v. United States Steel Corp.*, 223 F. 55, 67, 96, 110-11, 133 (D.N.J. 1915).

387. See text accompanying notes 317-330 *supra*.

economic affairs safely could be entrusted to corporate managers. The different interpretations of the facts and law of the district court and the court of appeals in respect to an officer's fiduciary duty to the corporation might thus have arisen from the judges' divergent attitudes toward the concentration of corporate power in managers.

Whatever the explanation for the court of appeals' inclination to uphold managerial discretion,³⁸⁸ the Third Circuit court of appeals' actions tipped the balance between managerial autonomy and corporate democracy in favor of managerial autonomy. The jurisprudential activity of the Third Circuit's court of appeals' judges thus further facilitated the concentration of economic power in corporate managers, who soon came to determine the allocation of goods and services in the national economy.³⁸⁹ The Third Circuit's court of appeals may have been so concerned with maximizing managerial autonomy that the district court's attempts to regulate and legitimize corporations were seriously undermined. Still, the maximization of managerial autonomy beyond the limits prescribed by

388. Another, and an extraordinarily intriguing explanation for the divergent philosophies between the district and circuit courts is that, in less than a year after the circuit court decided *Mallery*, it became clear that Judge Davis was a "malign influence" on the court. See *Root Ref. Co. v. Universal Oil Prods. Co.*, 169 F.2d 514, 533 (3d Cir. 1948). For example, in 1937 and 1938, although Judge Buffington was in his eighties, nearly blind and deaf, and fiercely adamant in his refusal to hire a clerk, opinions bearing his name routinely issued from the court of appeals. *Id.*, N.Y. Times, May 24, 1941, § 1, at 18, col. 1. It subsequently was revealed that Judge Davis wrote some of these opinions and attached the senior judge's name to them. In five of those opinions, Davis apparently decided in favor of former movie mogul William Fox because of "loans" from Fox totalling \$27,500. See N.Y. Times, Aug. 23, 1941, § 1, at 15. See generally *Root Ref. Co. v. Universal Oil Prods. Co.*, 169 F.2d 514.

Davis's apparent corruption was not restricted to the Fox cases. In 1944, the Court of Appeals for the Third Circuit had to re-open two patent cases decided by Davis because they were "tainted" with fraud. See *Root Ref. Co. v. Universal Oil Prods. Co.*, 169 F.2d at 535. See also N.Y. Times, June 20, 1944, § 1, at 23, col. 7. The winning party in those cases, Universal Oil Products Corporation, apparently had earned Davis's favor because Universal's counsel made a \$10,000 "loan" to Davis's cousin, which was to be "repaid" to Davis. There is no indication, however, that the Managers' Company in *Mallery*, see text accompanying notes 352-362 *supra*, exercised any influence on the court of appeals. Nonetheless, in *Mallery*, it appears that Judge Davis rendered a decision enabling one party, the class A majority stockholders, to take undue advantage of another party, the class B minority stockholders.

389. See A. CHANDLER, *supra* note 5, for the authoritative description of how corporate managers, through vertical and horizontal integration of entire industries, came to determine the allocation of manufactured goods in the national economy.

the Delaware district court may not necessarily have been detrimental to the public or to the minority shareholders, at least insofar as all benefited from a climate in which returns on investment were maximized.³⁹⁰

With the stock market crash of 1929, and the ensuing Great Depression, however, Americans' faith in the benefits to be gained by autonomy of industrial concerns was severely shaken. In particular, the economic chaos which ensued led many Americans to question whether the market in corporate securities could be allowed to continue with so little federal regulation. The result of this economic chaos was the passage of the Securities Act of 1933, the Securities Exchange Act of 1934, and the creation of the Securities and Exchange Commission. Actions that the Third Circuit's court of appeals had approved of, such as selling shares under less than full disclosure in *Hodgman*,³⁹¹ came to be seen as an evil in need of immediate eradication when millions lost their savings as the speculative fever of the twenties ended disasterously. The economic disaster appears to have resulted in both personal tragedy and doctrinal change in the Third Circuit. The Depression left court of appeals Judge J. Warren Davis badly in debt.³⁹² Davis had speculated lavishly in the stock market, perhaps as a result of a simple faith he, like Buffington, placed in the competence of American corporate industry. Davis's indebtedness to his brokers initiated the events that resulted in a major judicial scandal, in charges that Davis's financial weakness had led to corruption, and, finally, in his own court's declaring that Davis had allowed himself to be bought by litigants.³⁹³

Following the "Constitutional Revolution" of 1937, the Supreme Court appeared to alter its former insistence on the primacy of "freedom of contract" and the autonomy of industrial capitalists.³⁹⁴ In a related development some Third Circuit district and court of appeals judges, perhaps reacting to perceived excesses in favor of managerial autonomy established earlier by the court of

390. Cf. R. WINTER, *GOVERNMENT AND THE CORPORATION* (1978).

391. See text accompanying notes 331-350 *supra*.

392. *Root Ref. Co. v. Universal Oil Prods. Co.*, 169 F.2d 514, 530 (3d Cir. 1948).

393. *Id.* at 531.

394. See generally S. PRESSER & J. ZAINALDIN, *LAW AND AMERICAN HISTORY: CASES AND MATERIALS* 674-705 (1980).

appeals,³⁹⁵ and perhaps in some type of expiation for the perceived corruption of Judge Davis,³⁹⁶ began to issue opinions which sought to alter the doctrines regulating issuance of corporate securities and corporate governance. These alterations emphasized the responsibilities of issuers for full disclosure and expanded the operation of "corporate democracy." In short, these post-1937 opinions sought to tip back the balance, and ensure a greater degree of circumscription of managerial autonomy and an enhanced opportunity for stockholder participation in corporate governance.³⁹⁷

These personal and doctrinal developments in the federal courts of the Third Circuit, as well as the reactions which have recently resulted and which continue to effect corporate law doctrines, are the subjects of a final article on the history of the Third Circuit courts, to be published in the near future.

395. See text accompanying notes 316-362 *supra*.

396. See note 388 *supra*.

397. See, e.g., *Speed v. Transamerica Corp.*, 235 F.2d 369 (3d Cir. 1956); *Zahn v. Transamerica Corp.*, 162 F.2d 36 (3d Cir. 1947); *SEC v. Transamerica Corp.*, 163 F.2d 511 (3d Cir. 1947); *Kardon v. National Gypsum Co.*, 73 F Supp. 798 (E.D. Pa. 1947).