course were taken, the total capitalization would always have to be equivalent to the sum of the claims of the classes which were to be fully included. On the other hand, if the ICC felt that such an adjustment of the valuation was not feasible in a given case, it might be necessary for the ICC to provide for an issue of a class of securities inferior to the common stock, such as warrants or optional participation rights, in order to add to the compensation of a class which could not otherwise be satisfied. This latter solution was favorably considered in Congress and its use, in the discretion of the ICC, authorized by Section 77 as a means of conserving as much as possible the former junior interests.[31] But the issuance of such "immediately valueless paper"[32] may at least be questioned both on the ground that it adds to the complexity of capital structures which should be simplified, and on the ground that the issuance of these interests tends to place on the market securities which do not meet a reasonable investment standard. Furthermore, the existence of warrants or participation rights decreases the value of the common stock given to participants with more senior claims to the extent that while the new common stockholders must bear the first impact of future losses, they will not get the full benefit of future gains.

As mentioned in the discussion of the majority opinion, certain statements made in Congress indicate that at least some legislators did not expect that a large dissent by a class would be disregarded. In the act itself, however, Congress did not clearly specify the effect of a dissenting class vote, and it can be forcibly argued that the provisions should be interpreted so as to facilitate reorganization rather than permit further obstructions and delays. As Mr. Justice Douglas wrote prior to his appointment to the Court, with respect to the provisions of Section 77B of the Bankruptcy Act, "The problem raised by these provisions relating to the dissenter is the problem of the 'fair' plan—i.e., how much, if any, participation is to be given to each class."[33]

---

**Corporations—Voting by Shareholders—Duty of Creditor Holding Voting Control—[Federal].**—To assist the Maryland Casualty Company when it faced financial distress in the early 1930's, the Reconstruction Finance Corporation loaned to the Maryland system $7,500,000 in 1933 and an additional $10,000,000 in 1934. The loans were made to wholly owned Maryland subsidiaries which pledged with the RFC convertible preferred stock of Maryland that had been purchased from the parent with the proceeds of the loan. In 1937, the two issues of preferred which secured the separate loans were reclassified into one issue of 174,487 preferred shares. Each share carried 100 votes and was convertible by the holder to 50 shares of common stock, the only other outstanding

[31] 49 Stat. 913 (1935), 11 U.S.C.A. § 209(b)(3) (1946). See 79 Cong. Rec. 13,769, 13,771, 14,231 (1935).

[32] Ecker v. Western Pacific R. Corp., 318 U.S. 448, 476 (1943).

[33] SEC, Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees, Part VIII, 142 (1940).

Maryland issue. By virtue of holding this stock in pledge, the RFC acquired 95 per cent[1] of the aggregate voting rights of all outstanding Maryland shares. Although considerable financial recovery was made by Maryland from 1934 to 1942, both the RFC and the Maryland board of directors considered the company to be at a competitive disadvantage by virtue of certain inadequacies in its financial structure. In 1942 the RFC proposed to Maryland that in exchange for a new issue of 299,487 preferred shares, the RFC would surrender the preferred stock which it then held as security for its prior loans and would loan to Maryland an additional $12,500,000. The officers and directors of Maryland approved this plan, and in conformity with the company's charter, submitted the plan for the approval of two-thirds of each class of outstanding stock. The required two-thirds vote of the preferred was assured, since it was all held by the RFC. In order to make certain that the two-thirds vote of the common was obtained, there being 799,923 shares publicly held, the RFC converted into 1,474,350 shares of common 29,487 shares of the preferred stock which it held as security. Of the shares publicly held, only 443,567 were voted in favor of the plan, hence without the vote of the shares issued to the RFC through conversion, the required two-thirds approval of the common stockholders would not have been obtained. A committee representing owners of common stock who had voted against this refinancing plan brought a class suit to set aside the 1942 loan. The plaintiffs claimed that the RFC was without authority to convert the preferred shares, that its exercise of the conversion privilege under these circumstances was contrary to the intent of the parties, and that the refinancing plan was unnecessary or, if the plan was necessary, that the owners of stock should have had an opportunity to finance the plan. On appeal to the circuit court of appeals from a decree of the district court dismissing the suit for want of equity, *held*, the RFC had authority to convert the preferred shares and the evidence sustained the trial court's finding that the refinancing plan was necessary. *Todd v. Maryland Casualty Co.*[2]

Courts have been more reluctant to hold to fiduciary standards the group or individual owning or controlling[3] a majority of voting stock of a corporation than they have been to hold directors, typically the nominees of this controlling group, to such high standards of conduct.[4] The reason for this reluctance ap-

[1] Appellee's brief, p. 33.

[2] 155 F. 2d 29 (C.C.A. 7th, 1946).

[3] See Berle, Studies in the Law of Corporation Finance c. 3 (1928), also in 39 Harv. L. Rev. 673 (1926), for a discussion of the obligations owed by holders of management stock.

[4] Majority shareholders were held to owe no fiduciary obligations to minority shareholders in United States Steel Corp. v. Hodge, 64 N.J. Eq. 807, 54 Atl. 1 (1903); Windmuller v. Standard Distilling & Distributing Co., 114 Fed. 491 (C.C. N.J., 1902); Shaw v. Davis, 78 Md. 308, 28 Atl. 619 (1894). Such obligations were held to exist, however, in Southern Pacific Co. v. Bogert, 250 U.S. 483 (1919); Kavanaugh v. Kavanaugh, 226 N.Y. 185, 123 N.E. 148 (1919); Gamble v. Queens County Water Co., 123 N.Y. 91, 25 N.E. 201 (1890). See Ballantine, Corporations 595–96 (1927).

parently lies in the tendency to identify the interest of the majority shareholder with that of all the shareholders.[5]

When it has been shown, however, that the majority shareholder has an interest adverse to that of all the shareholders as a class, as for example when the majority shareholder of a subsidiary corporation is the parent attempting to liquidate the subsidiary,[6] the courts have realized that the best interest of all the shareholders as a class cannot be determined by an ordinary vote. Under such circumstances, the courts have restrained the dominance of the majority by subjecting the corporate decision which may have been tainted with the adverse and special interest of the majority to close judicial scrutiny at the behest of a minority shareholder.[7]

A more difficult problem arises when voting control of a corporation is acquired, not through stock ownership, but as security for a loan. When voting control is gained in this manner the adverse interest of the dominant creditor is more easily demonstrated. The creditor's objective is to protect his investment, and since, in general, profitable business operation assures him that protection, his interest and that of the shareholders would seem to coincide. In some situations, however, the creditor's interest might best be served by a rapid exploitation of present business opportunities in order to secure immediate profits, or by an ultra-conservative program which would minimize his risk but lengthen the period of his control. Either of these programs by the creditor might be clearly adverse to the best interest of the shareholders as a class. The shareholders accept this vulnerable position in exchange for the new chance for survival which the creditor gives the corporation. The shareholders should reasonably expect that the creditor who demands voting control as security for his loan might use such control in ways that may conflict with their interests.

From this proposition it might be argued that the shareholders, in granting control to the creditor, have relinquished all rights to challenge the creditor in his exercise of control. This argument, however, fails to recognize that the creditor has been granted control only to secure his investment. Once this factor is taken into consideration, it follows that the creditor should not be permitted to

[5] See Tracy, The Problem of Granting Voting Rights to Bondholders, 2 Univ. Chi. L. Rev. 208, 224 (1935).

[6] Lebold v. Inland Steel Co., 125 F. 2d 369 (C.C.A. 7th, 1941), where the majority was prevented from accepting payment for shares upon dissolution at a rate that would have deprived minority shareholders of their interest in good will.

[7] Relief to minority shareholders was forthcoming where the majority violated fiduciary obligations in Southern Pacific Co. v. Bogert, 250 U.S. 483 (1919); Lebold v. Inland Steel Co., 125 F. 2d 369 (C.C.A. 7th, 1941); Nave-McCord Mercantile Co. v. Ranney, 29 F. 2d 383 (C.C.A. 8th, 1928); Kavanaugh v. Kavanaugh, 226 N.Y. 185, 123 N.E. 148 (1919); Hyams v. Calumet & Hecla Mining Co., 221 Fed. 529 (C.C.A. 6th, 1915); Stebbins v. Michigan Wheelbarrow & Truck Co., 212 Fed. 19 (C.C.A. 6th, 1914); Wheeler v. Abilene Nat'l Bank Bldg. Co., 159 Fed. 391 (C.C.A. 8th, 1908); Jones v. Missouri Edison Electric Co., 144 Fed. 765 (C.C.A. 8th, 1906); Central Trust Co. of New York v. Bridges, 57 Fed. 753 (C.C.A. 6th, 1893); Ervin v. Oregon R. & Navig. Co., 27 Fed. 625 (C.C. N.Y., 1886).

exercise control in a manner not consistent with this limited interest, nor should he unreasonably prolong the period during which he remains in the dominant position. The test of a reasonable period will of necessity be broad, since many variables must be considered, such as the size of the creditor's investment, the capital structure and nature of the enterprise, and the general economic outlook. The creditor in control should be conceded a wide latitude of permissible conduct, but from such a concession it does not follow that there are no limits on what the creditor may do. These limits must be set by the test of reasonable conduct under all the circumstances. And whether the creditor is guilty of misfeasance or nonfeasance[8] the shareholding class should be protected from attempts by the creditor to perpetuate unreasonably his period of control. The duty to be imposed on the creditor to use his control only to protect his loan and not to prolong unnecessarily his period of control can be elevated to the dignity of a fiduciary obligation, thereby recognizing that although the creditor occupies a position adverse to the shareholders he cannot ignore the interests of this group, which is peculiarly unable to protect itself.[9]

If these propositions are accepted, the ultimate question which should have been decided by the court in the instant case was whether the loan proposed by the RFC in 1942 was necessary to protect its earlier loans. The exercise of the conversion privilege by the RFC in order to control the common vote did not of itself violate any of the obligations which the RFC as controlling creditor owed to the Maryland common stockholders. All parties should have reasonably expected that the RFC would exercise such power to prevent the common stockholders from frustrating attempts by the RFC to protect its $17,500,000 investment. The RFC should be recognized as being in the same position as if it had originally demanded a majority of common stock as security instead of convertible preferred shares. If the refinancing plan was a reasonable means to protect the RFC's previous loans, the plaintiff's contention that the conversion and voting was per se a violation of the RFC's fiduciary obligations would deny RFC the protection it demanded.

The issues which should have been controlling were raised by the argument of the plaintiff that additional funds were not needed, but that if funds were need-

[8] In Mackintosh v. Flint & P.M.H. Co., 34 Fed. 582 (C.C. Mich., 1888), the preferred shareholders were given voting control until seven successive annual 7 per cent dividends should be paid the preferred, after which control would revert to the common shareholders. After seven years the common shareholders brought suit to obtain voting control, claiming that the dividends were not paid because the preferred shareholders desired to retain control. The court found a violation by the preferred shareholders of their fiduciary obligations to the common shareholders. The case is discussed in Tracy, op. cit. supra note 5, at 225–26.

[9] Berle and Means maintain that fiduciary obligations are owed to shareholders by management and that the "device used for 'control' seems to be immaterial—whether it be voting trust, domination by a stockholder, or possibly even domination by a creditor." Berle and Means, The Modern Corporation and Private Property 239 (1932). See Tracy, op. cit. supra note 5, at 229: "It must be assumed that their desire is not to make a speculative profit from operating the corporation but only to obtain payment of the fixed obligations due them."

ed the owners of common stock should have been given an opportunity to furnish the added capital. The substance of these contentions is that the RFC had violated obligations to the owners of common stock to use its control in a manner consistent with the purpose for which it acquired control and that it violated the duty to return control to the stockholders as soon as was expedient.

While both the trial and circuit courts examined the refinancing plan and found it to be fair, there is no indication of what criteria were employed by either in reaching this conclusion. The opinion of the circuit court might be taken to mean that the decisive factor was a presumption that the RFC as a public agency would not overreach in the exercise of its control. Thus the court emphasized that ". . . . the RFC was a corporation not engaged in business for profit with the attendant motive oftentimes found to take advantage of those with whom it deals . . . . it was an agency created by the government for the sole purpose, as far as we are aware, of rendering assistance by the use of government funds to those in financial need. . . . ."[10]

While the motive which may impel a large public agency like the RFC "to take advantage of those with whom it deals" is not as apparent as the profit motive of the private creditor, the possibility that the RFC could have acquired peculiar patronage interests in the management of Maryland should not be ignored. Recent criticisms of the patronage power which the RFC, ICC, district courts, and trustees have acquired in railroad reorganization proceedings[11] indicate that fair conduct of public officials is not to be presumed merely because they occupy positions of public trust.

The circuit court opinion also indicates that little attention was paid to the suggested test of whether the loan was needed to protect the prior investment of the RFC. The primary reason advanced by the RFC and the Maryland directors for the necessity of the loan was the inadequacy of the financial structure of Maryland.[12] An examination of the RFC brief indicates that this inadequacy was a low ratio of capital and surplus to premiums written.[13] The purpose of maintaining a sound ratio was explained in the brief as ". . . . not so much to increase the volume as to improve the quality of the business."[14] Apparently, the RFC had no fear for the safety of its prior loans if it was willing to invest an additional $12,500,000 to improve only the quality of Maryland's business.

The court apparently did not recognize any obligation on the part of the RFC to return the control of Maryland to the owners of common stock as soon

[10] Todd v. Maryland Casualty Co., 155 F. 2d 29, 38 (C.C.A. 7th, 1946).

[11] S. Rep. 1170, 79th Cong. 2d Sess. 96–97 (1946); Chicago Sun p. 1 (Jan. 2–7, 1946).

[12] By having the RFC make the additional loan to the subsidiary corporation which then pledged Maryland stock with the RFC, the balance sheet of Maryland was dressed up in two ways: liquid assets and equity interest increased, while liabilities remained constant. This same device was used when the prior loans were made.

[13] Appellee's brief, p. 21.

[14] Ibid.

as was expedient. The opinion implied that the plaintiffs were ungrateful in attempting to shorten the period of RFC control since they ". . . . having been saved from drowning, were not content to merely ride in the boat which had been so successully navigated by RFC but decided to take over and row it for themselves."[15] This attitude is in sharp contrast, not only with the duty which a private creditor in control of a corporation should owe to the stockowners, but with the criticisms of a recent Senate committee which urged that the RFC withdraw from reorganization proceedings as soon as possible.[16]

Soon after the decision in this case a settlement was reached whereby the entire $30,000,000 indebtedness of Maryland to the RFC was discharged through a sale of preferred stock to the public.[17] The plaintiff's committee had already announced its intention to appeal the decision. In the light of recent extensions of corporate fiduciary obligations,[18] it is possible that the Supreme Court would have imposed upon creditors, including government agencies, in control of corporate affairs a higher standard of fairness. The Supreme Court has said that a "dominant or controlling stockholder or group of stockholders" is a fiduciary, and "where any of their contracts or engagements with the corporation is challenged the burden is on the director or stockholder not only to prove the good faith of the transaction but also to show its inherent fairness from the viewpoint of the corporation and those interested therein. . . . . The essence of the test is whether or not under the circumstances the transaction carries the earmarks of an arm's-length bargain."[19]

The transaction in the instant case might well be considered as not within the usual conception of "an arm's-length bargain."

---

**Federal Courts—Relation to State Courts and Law—Effect of State Rules of Forum Non Conveniens under Erie v. Tompkins—[Federal].**—The plaintiff, a Virginia corporation, brought an action in a federal district court in New York for damages arising from a tort allegedly committed in Virginia by a Pennsylvania corporation. The action was dismissed by the district court on the ground of forum non conveniens.[1] On appeal to the Circuit Court of Appeals for the Second Circuit, *held*, on the basis of the federal precedents, the doctrine of forum non conveniens cannot be invoked merely because a tort cause of action against a foreign corporation arises in another jurisdiction; and the defend-

[15] Todd v. Maryland Casualty Co., 155 F. 2d 29, 38 (C.C.A. 7th, 1946).

[16] S. Rep. 925, 79th Cong. 2d Sess. 33 (1946).

[17] Moody's Investors Service, Banks & Finance 1749, 1795 (Aug. 7, July 17, 1946).

[18] Young v. Higbee, 324 U.S. 204 (1945); Consolidated Rock Products Co. v. DuBois, 312 U.S. 510 (1941); Pepper v. Litton, 308 U.S. 295 (1939); Taylor v. Standard Gas & Electric Co., 306 U.S. 307 (1939).

[19] Pepper v. Litton, 308 U.S. 295, 306–7 (1939).

[1] Gilbert v. Gulf Oil Corp., 62 F. Supp. 291 (N.Y., 1945).